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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1952

No. 521

CENTRAL BANK, A CORPORATION, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED DECEMBER 30, 1952
CERTIORARI GRANTED MARCH 9, 1953

SUPREME COURT OF THE UNITED STATES

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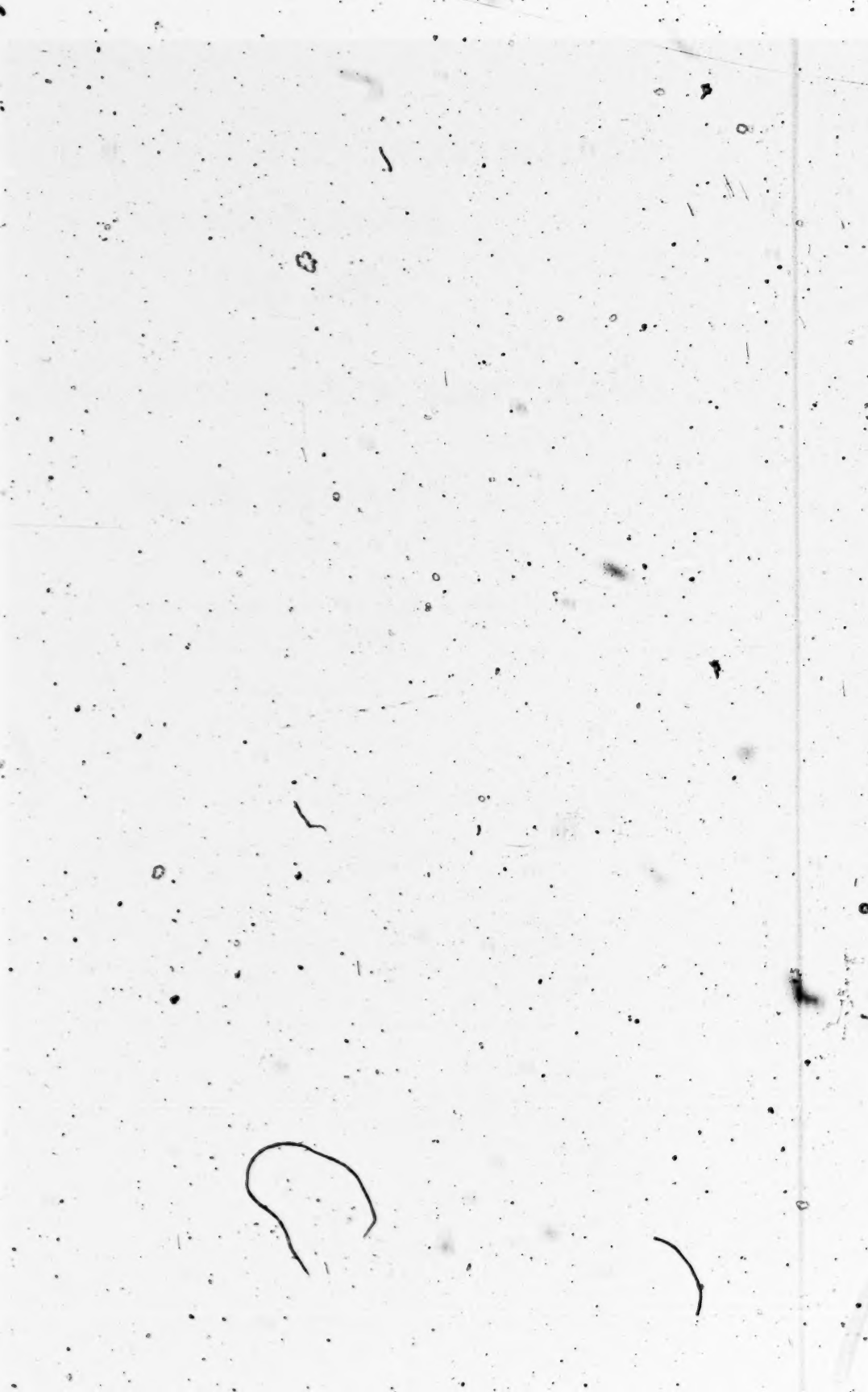

[fol. 1]

IN THE UNITED STATES COURT OF CLAIMS

No. 49825

CENTRAL BANK, a corporation, Plaintiff,

v.

UNITED STATES OF AMERICA, Defendant.

PETITION—Filed September 22, 1950

To the Honorable, the Chief Judge and the Associate Judges of the Court of Claims of the United States:

I

The plaintiff, a corporation duly organized under and by virtue of the laws of the State of California, with its principal office and place of business located in the City of [fol. 2] Oakland, State of California, files this petition to recover from the United States of America the sum of $110,966.08, or such greater amount as may be legally due, including interest as required by law. The said amount of $110,966.08 represents the sum legally due the plaintiff, as assignee of Graham Ship Repair Company, Oakland, California, by the defendant and illegally withheld from the plaintiff by the defendant.

II

On December 30, 1944, Graham Ship Repair Company, Oakland, California, entered into a contract with the Navy Department of the United States for ship repair work. Said contract is known and identified as NObs-10230 and a copy of said contract is attached hereto as plaintiff's Exhibit 1. Agreement amending said contract is attached hereto as plaintiff's Exhibit I(a).

III

After the execution of said contract with the Navy Department of the United States, the Graham Ship Repair Company arranged with the plaintiff, Central Bank, Oak-

land, California, for the financing of the work and as consideration and security for the funds to be advanced the Graham Ship Repair Company on January 31, 1945 assigned the contract and the proceeds payable thereunder to the plaintiff bank. This assignment was made and properly executed under the provisions of the Assignment of Claims Act of 1940, 54 Stat. 1029. A copy of the said assignment is attached hereto as plaintiff's Exhibit 2.

[fol. 3] The Navy Department, the Contracting Officer and the representatives of the defendant were all duly notified of the said assignment made on January 31, 1945 as required by the provisions of the Assignment of Claims Act of 1940. Copies of the notice of assignment, to which was attached a copy of the said assignment, are attached hereto as Exhibits 3, 4 and 5.

At all times mentioned in this petition plaintiff was engaged in business as a bank.

IV

The Assignment of Claims Act of 1940, supra, provides that:

> Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

The contract here involved (Plaintiff's Exhibit 1), under article 15(o), contains a provision to that effect pursuant to which the referred to assignment was executed.

V.

After the execution of said assignment the plaintiff did advance and loan to said Graham Ship Repair Company substantial sums of money to pay for labor and material

costs in connection with the work of said Graham Ship [fol. 4] Repair Company under said contract NObs 10230, and there is now, and at all times since the completion of said contract prior to December 1, 1946, there has been due and unpaid an amount in excess of $110,966.08 on account of said loans, for which unpaid amounts Graham Ship Repair Company is indebted to plaintiff; and at all times herein mentioned the amounts due or to become due under Contract NObs 10230 were pledged and assigned to plaintiff as aforesaid as consideration and security for said loans.

VI

The work under the said contract NObs 10230 was duly completed by said Graham Ship Repair Company early in 1946 and prior to December of 1946. The Navy Department made an audit in due course, as required by law, and administratively determined that there was due under the said contract assigned to plaintiff as shown above, and as a result of the work having been duly completed, the sum of $110,966.08, and your plaintiff has made due claim for the payment to it of said sum.

VII

On account of conflicting claims for the aforesaid sum of $110,966.08 made by the Collector of Internal Revenue, San Francisco, California and your plaintiff, as assignee under the Assignment of Claims Act of 1940, the Navy Department transmitted the vouchers for the payment of $110,966.08, on or about June 25, 1949, to the Comptroller General of the United States for final approval of payment of the $110,966.08 to your plaintiff.

[fol. 5]

VIII

The claim of the Collector of Internal Revenue of the United States at San Francisco, California to the aforesaid sum of $110,966.08 arose by reason of the filing of liens in December of 1946 by said Collector against Graham Ship Repair Company for unpaid Federal taxes. The said Collector claimed that said Graham Ship Repair Company was liable to said Collector and/or the Commissioner of

Internal Revenue of the United States for $453,469.55 in Federal income taxes and $11,462.91 Federal unemployment taxes which Graham Ship Repair Company, as agent for the Government, withheld from employees as withheld income tax and unemployment insurance (social security) taxes on their wages, and then failed to transmit to the Government. In December of 1946 the Commissioner of Internal Revenue of the United States and/or said Collector of Internal Revenue issued and made assessments of the aforesaid Federal taxes against the Graham Ship Repair Company and after the assessment of said taxes, and in December of 1946, the said Collector of Internal Revenue filed the said liens against Graham Ship Repair Company.

IX

On May 18, 1950 the Comptroller General of the United States, by a letter addressed to your plaintiff, refused to approve payment of the said sum of $110,966.08 to your plaintiff; rejected your plaintiff's claim to said sum; determined that the taxes claimed by the said Collector of Internal Revenue could be offset against the amounts due on the contract; approved the claim of said Collector; and held that the sum of $110,966.08 should be applied against [fol. 6] the sums alleged by said Collector to be due for said Federal taxes. In said letter the Comptroller General of the United States admitted that there was due and owing under the contract here involved the sum of $110,966.08; that the plaintiff was properly and legally an assignee of the contract under the said Assignment of Claims Act of 1940; that the assignment from Graham Ship Repair Company to your plaintiff complied with the provisions of the Act; and that your plaintiff had complied with the requirements of said Act. The said Comptroller General of the United States held, however, that the said Federal taxes alleged to be due from Graham Ship Repair Company by said Collector were not "any indebtedness of the assignor to the United States arising independently of such contract" and could be set-off, therefore, against the amounts due under the contract. A copy of said letter of the said Comptroller General of the United States is attached hereto as plaintiff's Exhibit 6.

X

Being aggrieved by the said decision and determination of the Comptroller General of the United States; believing that the decision and determination of the said Comptroller General is clearly erroneous and that your plaintiff is fully, justly and legally entitled to the payment to it by the defendant of the full sum of the said $110,966.08, your plaintiff files this petition for the recovery from the defendant of the full sum of $110,966.08 plus interest as required by law.

XI

Your plaintiff alleges that the said decision and determination of the said Comptroller General of the United [fol. 7] States was illegal, improper, unjust, erroneous and a clear violation of the provisions of the Assignment of Claims Act of 1940 and the intent and purpose thereof and that the claim of your plaintiff for the payment to it of the full sum of $110,966.08 was proper, valid, legal and should have been allowed and approved in full by the Comptroller General of the United States under the provisions of the Assignment of Claims Act of 1940.

XII

Your plaintiff alleges that the liens of the said Collector of Internal Revenue at San Francisco, California were filed long after the valid assignment to the plaintiff of the contract here involved and that, as conceded by the Comptroller General, the said liens were not prior or superior to the plaintiff's claim under said assignment executed under the provisions of the Assignment of Claims Act of 1940, protecting lending institutions in the financing of Government contracts for the purposes of national defense. The liens of said Collector of Internal Revenue were not filed until December of 1946 whereas the assignment here involved was executed and became legal and binding upon all parties concerned, including the plaintiff and the defendant, on January 31, 1945.

XIII

Your plaintiff alleges that, as was also conceded by the Comptroller General, the amount of $110,966.08 due your plaintiff under said assignment of January 31, 1945 was not impressed with any valid or legal trust for Federal taxes. Under the facts of this case, the contract rights [fol. 8] and funds due under the contract were assigned to the bank before any liability arose and long before the assessment of said Federal taxes or the filing of liens by the said Collector. If said Federal taxes here under consideration constituted trust funds for the Government of the United States, and if the contractor converted such funds to his own use, violated the trust or embezzled the trust funds, such acts and the indebtedness of the contractor resulting therefrom for which the contractor itself might be civilly or criminally responsible constituted acts of the contractor-assignor "arising independently of such contract" and therefore not allowable as an offset under the Assignment of Claims Act of 1940 enacted for the protection of banks and financial institutions in financing Government contracts against moneys due under an assigned contract. The said Act clearly provided that payments due the assignee under an assigned contract "shall not" be subject to reduction or set-off "for any indebtedness of the assignor to the United States arising independently of such contract".

XIV

Your plaintiff alleges that the obligation of the assignor, Graham Ship Repair Company, for the payment of Federal taxes arose independently of the contract here involved and by reason of the Federal Revenue laws. The Federal Revenue laws provided and imposed the liability of the contractor for Federal taxes. The Navy contract assigned to plaintiff under the Assignment of Claims Act of 1940 did not impose the liability of the contractor for Federal taxes and had nothing to do with the Federal Revenue [fol. 9] Statutes under which liability for Federal taxes arise. The amount of Federal taxes due from the contractor are determined by the Federal Revenue laws and not by

the Navy contract here involved. The Federal taxes are administered and collected by a separate and distinct department of the Federal Government, the Treasury Department, as disinguished from the Navy Department, which negotiated the contract here involved. Since the liability of the contractor for Federal taxes and any obligation to pay or collect Federal taxes arose under the Federal Revenue laws and "independently" of the contract here involved, the alleged liability of the contractor for Federal taxes cannot be legally or properly set off against the payment due the assignee, the plaintiff herein, under the provisions of the Assignment of Claims Act of 1940.

XV

Plaintiff further alleges that the legislative history of the Assignment of Claims Act of 1940 shows and demonstrates that the said Act was passed and enacted by the Congress of the United States for the purposes of financing the national defense and to protect and to aid banks and other financial institutions in financing and loaning money to contractors dealing with the Federal Government during the war emergency.

During the United States Senate hearings on the Assignment of Claims Act of 1940 and in explaining its provisions, Senator Barkley stated that under the Act's provisions "it shall not be permissible to offset against the claim or contract later an indebtedness which the contractor may owe the Government on account of some other contract or some [fol. 10] other situation. In other words it is an effort to make it possible for contractors to go to private lending institutions and, by assigning their contracts with the Government obtain private funds in order to carry out the work, instead of coming to some public lending agency".

Under this expression of legislative purpose the Government would have no right to withhold from an assignee moneys due under an assigned contract merely because the assignor contractor was indebted to the Government because of unpaid taxes.

XVI

It is further alleged by your plaintiff that the decision and action of the Comptroller General of the United States in refusing payment to your plaintiff violates and sets at naught the very purpose for which the Assignment of Claims Act of 1940 was enacted, the protection of financial institutions, such as your plaintiff, in promoting the interests of national defense. And to hold, as the Comptroller General did in his letter of May 18, 1950, that an indebtedness of the contractor for taxes which he collected from his employees as an agent of the Government and failed to remit to the Government is an indebtedness arising out of the contract which was assigned to the plaintiff as aforesaid and is an indebtedness which may be offset against amounts due for work performed under said contract and payable to plaintiff as assignee of said contract, is not only illogical and improper but also constitutes an illegal interpretation of the Assignment of Claims Act of 1940 and also violates the purpose and intent thereof.

Your plaintiff alleges that the assignment of the contract was valid when made on January 31, 1945; that at that [fol. 11] time your plaintiff could have had no knowledge that the contractor would not pay all taxes claimed by the said Collector at San Francisco or the Commissioner of Internal Revenue of the United States; that your plaintiff acted in good faith in accepting the assignment of January 31, 1945 and at all times since said date; that your plaintiff is entitled to the protection afforded by the Assignment of Claims Act of 1940; and that said Act was enacted by Congress for the very purpose of safeguarding the plaintiff and other lending institutions from the very situation, among others, that has arisen in this case.

XVII

No action upon the claims herein made other than that herein stated has been taken before Congress or any other of the departments of the United States, or in any Court other than the petition filed in this Court.

Your plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to

rebellion against said Government. Your plaintiff is the sole and absolute owner of the claim herewith presented and has made no transfer or assignment of said claim or any part thereof, and is justly entitled to the amount claimed herein from the United States after allowing all just credits and off-sets.

Your plaintiff believes the facts as herein stated to be true.

Wherefore, plaintiff prays for judgment in its favor for said sum of $110,966.08, or for such other and further [fol. 12] amount as this Court may find to be justly due your plaintiff together with interest as provided by law and for such other and further relief as this Court may deem just and proper.

Llewellyn A. Luce, 937 Munsey Building, Washington, D. C., George H. Koster, 300 Montgomery Street, San Francisco 4, California. Attorneys for Plaintiff.

Duly sworn to by —— —— jurat omitted in printing.

[fol. 13] EXHIBIT 1 TO PETITION

Navy Department
Bureau of Ships
(Revised 4-19-43)
(With Revisions to 10-28-43)
(Corrected)

Contract No. NObs 10230

Contract
for the repair or alteration of
vessels at Oakland, California
United States of America
Navy Department

(Government)

Graham Ship Repair Co. (A Partnership)
501 First Street, Oakland, California

(Contractor)

Dated: 30 December 1944

Effective Rates Per Payable Hour—

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1943				
1944				
1945				
1946				
1947				

Rate includes use of Dry Dock and Marine Railways: Yes X No

Three signed copies must be returned to the Bureau of Ships, Navy Department, Washington, D. C., via Naval Cost Inspector at Contractor's plant. Do not send them [fol. 14] direct to Washington. Hand them to your Naval Cost Inspector for endorsement. One executed copy will be returned for your files.

Each quarter the report required under Article 5(d) must be handed to Naval Cost Inspector at Contractor's

plant for endorsement. Do not send the quarterly reports direct to Washington.

NAVships (776)

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This negotiated contract entered into as of this 30th day of December, 1944, by and between the United States of America (hereinafter called the "Government"), represented by the Contracting Officer executing this contract, and Graham Ship Repair Co. a partnership organized and existing under the laws of the State of California (hereinafter called the "Contractor"),

Witnesseth:

Whereas, the Government will from time to time require the repair, completion, alteration of or additions to Naval vessels of the Government and other nations and merchant vessels of United States and other registry and portions thereof, plans, spare parts, and equipment therefor;

Whereas, the Contractor has an organization, plant, and facilities at Oakland, Calif. (hereinafter called the "plant") of sufficient capacity for doing such work and is willing, whenever required by the Navy Department, to do such work as conditions at the time will permit it to undertake; and

[fol. 16] Whereas, the Contracting Officer has determined that this contract will facilitate the prosecution of the war;

Now, therefore, in consideration of the premises and of the mutual covenants and agreements hereinafter contained, the parties hereto mutually agree as follows;

Article 1.—Purpose

The purpose of this contract is to establish the terms upon which the Contractor will provide berthing, drydocking, marine railway, shipyard, and other facilities together with materials and services for effecting expeditious repairs, completion, alterations of and additions to Naval vessels of the Government and other nations and merchant vessels of United States and other registry and portions thereof which may be ordered to the Contractor's plant or another location for the performance of work hereunder from time to time during the period of this contract.

Article 2.—Preliminary Arrangements

Whenever the Government desires the Contractor to effect the repair, completion, alteration of or addition to a

Naval vessel of the Government or of another nation or a merchant vessel of United States or other registry; the Government shall notify the Contractor of the nature of the work to be performed, the date proposed for delivery of the vessel to the Contractor, and the desired date for completion of the work by the contractor. Upon being so notified, the Contractor shall promptly advise the Government regarding its ability to accept the vessel and to perform the work as required. If satisfactory dates for com- [fol. 17] mencing and completing the work are agreed upon, the Contractor shall make the necessary arrangements for receiving the vessel on the agreed date, and for berthing her alongside its wharves or in its drydock or on its marine railway, or in the vicinity of its plant, or other location where the work is to be performed, as required, such arrangements to be satisfactory in each case to the authorized representative of the Chief of the Bureau of Ships, such representative being hereinafter referred to as the "Naval Inspector".

1

Article 3.—Job Orders

As soon as practical after the arrival of the vessel at the Contractor's plant or in the vicinity thereof or other location where the work is to be performed, the items of work which it is desired to accomplish on such vessel shall be inspected jointly by the Contractor and the Naval Inspector and job orders setting forth the items of work to be accomplished shall be prepared by the Naval Inspector. If inspection requires the opening up of machinery and equipment and its closing after inspection, a job order shall be prepared covering that work. Items of repair shall be set forth in separate job orders from those setting forth items of alteration, completion or addition and each job order shall specify in reasonable detail the repair or completion, alteration or addition necessary to be accomplished on an individual item. When a job order is agreed upon, it shall be signed by an officer or other authorized representative of the Contractor and by the Naval Inspector. If additional work is to be done on such vessel, addi-

[fol. 18] tional job orders shall be prepared and executed as provided in this article.

Article 4.—Performance

(a) Upon the signing of a job order, the Contractor shall promptly commence the work specified therein and diligently prosecute the same to completion to the satisfaction of the Naval Inspector.

(b) The Contractor shall furnish all necessary material, labor, equipment, power, accessories, facilities, and such other things as are necessary for accomplishing the work specified in the job order.

(c) The Contractor shall furnish electricity, compressed air, steam, fresh water, and flushing water to the ships as required by the Naval Inspector and shall furnish for the use of naval personnel tools and equipment, including falls, stage planking, cranes, scrapers, hose, paint pots and brushes as required by the Naval Inspector in such quantities as required.

(d) The Contractor shall, without a job order being required:

(i) Furnish the Naval Inspector or Inspectors and Cost Inspector or Inspectors, with suitable offices, office equipment and telephones at or near the Contractor's plant, provided that requests for increased office space shall be approved in writing by the Contracting Officer;

(ii) Make available the usual washroom and toilet facilities for the use of the personnel of the vessel while in dry dock or on marine railway and supply and maintain in a condition satisfactory to the Naval Inspector suitable brows and gangways from the dry dock or marine railway to the vessel;

[fol. 19] (iii) Store salvage, scrap or other material designated by the Naval Inspector in the Contractor's plant up to sixty days;

(iv) Perform, or pay the cost of, any reconditioning or repairing rendered necessary as the result of the use by the Contractor of any of the vessel's machinery, equipment or fittings, including winches, pumps, rigging, or pipelines.

(e) The Contractor shall conduct dock and sea trials of the vessel as required by the job orders. Such trials shall be carried out by the vessel's crew with representatives of the Contractor on board to check performance and satisfactoriness of operation.

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(f) The Contractor shall provide and install all fittings and appliances which may be necessary for the dock and sea trials, to enable the representative of the Government to determine whether the requirements of the job orders, plans and specifications have been met, and the Contractor shall be responsible for the care, installation and removal of instruments and apparatus furnished by the Government for such trials.

(g) The Contractor shall furnish on a job order, when requested and if available, temporary stenographic assistance to the Naval Inspectors and Naval Cost Inspectors.

(h) If the Contracting Officer shall determine during the course of the work on any vessel that the work is being inefficiently performed, he shall so notify the Contractor in writing during the course of the work on such vessel stating in such notice wherein the said work is being inefficiently performed.

[fol. 20] Article 5.—Compensation

(a) The Contractor shall be paid for work done under all job orders hereunder amounts accepted by the Naval Cost Inspector as follows:

(i) At the rate of $2.25 for each hour of Payable Hours of Direct Labor. "Payable Hours of Direct Labor" is defined for the purpose of this contract as: The sum of the quotients obtained by dividing the total wages of workmen performing direct labor on the work by their respective wage rates. If the Contractor consistently does so for all purposes of this contract, it may, at its option, include shift work and dirty work premiums and allowances for lunch periods as a portion of the wage rates; otherwise, wage rates shall be first shift straight time rates. Total wages shall include but not be limited to straight time, over-

time, shift work, allowances for lunch periods and rest periods required by law, travelling time, dirty work premiums and incentive bonuses. Direct labor shall be labor performed by the Contractor's employees directly upon and properly chargeable directly to the work; foremen (including leading men, snappers, quartermen, etc.) shall be considered as direct laborers if the Contractor consistently classifies in its accounting system the wages of the foremen with the wages of direct labor but otherwise the wages of foremen shall be included with indirect expenses.

When wage scale rates on new construction work, as defined in the applicable Zone Standard Agreements, apply to work under this contract, the billing rate above set forth, or as hereafter agreed, shall be reduced by the difference between the hourly straight time wage scale of first-class [fol. 21] mechanics on repair work and the same wage scale on new construction work as contained in the applicable Zone Standard Agreement.

(ii) The amount of each subcontract hereunder made with the approval of the Naval Inspector as required by Article 10 hereof (except subcontracts for temporary facilities, tools and equipment and services in connection therewith) and of the Contractor's Cost of Direct Materials (as hereinafter defined). The "Contractor's Cost of Direct Materials" is defined as:

The net purchase price, including but not limited to transportation charges and sales and excise taxes which the Contractor is required to pay, of all purchased materials and fabricated parts entering directly into the work or which are used directly in fabricating or processing such materials and parts and all items directly chargeable to the work not otherwise chargeable under the provisions of this paragraph (a), provided said charges are approved by the Naval Cost Inspector; but not including the amount of any subcontract charged hereunder. Purchases made specifically for the work will be taken at their net purchase prices as provided in paragraph (e) of this Article 5. To the extent that any division or affiliate of the Contractor shall furnish any materials, supplies or equipment hereunder which in the industry are usually procured from

others in performing a ship repair, completion, alteration or addition contract, the cost, for the purposes of this paragraph, of such materials, supplies or equipment may be equal to but not in excess of the prevailing market prices. Withdrawals from regular stores or stock rooms will be [fol. 22] taken at their cost under any recognized method of pricing stores withdrawals conforming to sound accounting practices and consistently followed. Material costs will include only the cost of materials required to be used for the work. Direct materials will include consumable supplies such as cleaning material, template material and pattern stock, used directly in connection with the work although not permanently incorporated therein.

(iii) Charges for use of temporary facilities, tools and equipment and services in connection therewith hired from third persons for the performance of any part of the work with the approval of and at rates of hire approved by the Naval Inspector, as required by Article 10 hereof;

(iv) For drydock, marine railway, floating derrick, and tugboat services furnished at rates specified in Schedule "A" attached hereto, if such rates are provided in a Schedule "A" hereto;

(v) For electricity, steam, fresh water, compressed air, and flushing water furnished to a vessel, at rates approved by the Naval Cost Inspector;

(b) Anything in this contract to the contrary notwithstanding, the Contracting Officer may require the Contractor to enter into negotiations with the Contracting Officer for the purpose of agreeing upon a price as in this paragraph (b) provided.

(i) Upon notice in writing from either the Contracting Officer or the Contractor to the other within sixty (60) days after the end of each calendar quarter or within sixty (60) days after the end of any shorter fiscal period or within sixty (60) days after completion and billing for all work on an individual vessel, the Contracting Officer and the Contractor shall negotiate to determine the price to be [fol. 23] paid for work billed during such quarter or shorter time or on such vessel as provided in such notice. When an

agreement is reached as to the price to be paid, it shall be set forth in a written supplemental agreement.

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(ii) If, within thirty (30) days after commencing such negotiations, no agreement has been reached regarding the price, the question may be submitted for final determination to the Secretary of the Navy by the Contractor or by the Contracting Officer. A Board composed of one representative each of the Secretary of the Navy, the Secretary of War and the Administrator, War Shipping Administration, after considering any matters which may be presented to it by the Contractor as hereinafter provided, shall make its recommendations regarding the question to the Secretary of the Navy. The Contractor may, if he so desires, within ten (10) days from and after the date on which the Contractor submits the question to the Secretary of the Navy, or from and after the date the Contractor receives notice that the Contracting Officer has submitted the question to the Secretary of the Navy, present in writing to such Board any facts or circumstances which may, in the Contractor's opinion, have a bearing upon the price to be determined. After considering the recommendations of the Board, the Secretary of the Navy shall determine the price to be paid, and his determination shall be final and conclusive.

(iii) If the total of the payments made to the Contractor pursuant to paragraph (a) of this Article 5 for work during the period or on the vessel for which a price has been agreed [fol. 24] to or determined pursuant to this paragraph (b) exceeds such price, the amount of such excess shall be credited against payments to which the Contractor is otherwise entitled hereunder or paid to the Government by the Contractor at the option of the Government. If such total is less than such price, the Contractor shall be paid the amount by which such total is less than such price. Neither the pendency of negotiations concerning a price, nor the fact that any question of a price has been submitted to the Secretary of the Navy for determination, as provided in paragraph (b)(ii) of this Article 5, shall be construed as a basis for withholding any payments due under paragraph (a) of

this Article 5, or any credits or payments due under this paragraph (b)(iii), or any credits or payments due under paragraph (b) of Article 6.

(iv) When amounts payable in respect to work done are finally settled, agreed upon or determined pursuant to paragraphs (a) and (b) of this Article 5, the Contracting Officer shall certify to such amounts.

(c) The compensation paid to the Contractor pursuant to paragraphs (a) and (b) hereof shall include all the amounts to which the Contractor is entitled under this contract, except any amount to which the Contractor is entitled under Articles 9, 11, 12, 22 and 30(c).

(d) The rate for Payable Hours of Direct Labor in paragraphs (a) (i) of this Article 5 shall be subject to revision as follows:

Within forty-five (45) days after the end of each calendar quarter during the existence of this contract, the Contractor shall submit to the Contracting Officer:

[fol. 25] (i) A report of the total number of Payable Hours of Direct Labor (computed in the manner provided for computing Payable Hours of Direct Labor in paragraph (a)(i) of this Article 5) for all repair, completion, alteration and addition work, whether under this contract or otherwise, performed by the Contractor at the plant or at another location for the performance of the work hereunder, during the preceding quarter, and the total amount of wages (including straight time, othertime, shift work, allowances for lunch periods and rest periods required by law, travelling time, dirty work premiums and incentive bonuses) paid therefor. Also a report of the total wages paid for direct labor for work by the plant other than repair, completion, alteration and addition work;

(ii) A report of the indirect expenses of the Contractor's entire plant for the preceding quarter classified in reasonable detail in accordance with the Contractor's accounting system. Such indirect expenses shall comprise all expenses of the Contractor, except the cost of materials and services for which charges are made under sub-paragraphs (i), (ii), and (iii) of paragraph (a) of this Article 5, paragraph (c) of Article 9, Article 12 and Article 22

hereof and all costs directly applicable to work not under this contract, subject to the limitations and exclusions described in paragraphs 43 through 46, 48 through 52 and Paragraph 54 of the pamphlet "Explanation of Principles for Determination of Costs under Government Contracts" printed by the U. S. Government Printing Office, April 1942;

(iii) A report of the total amounts charged by the Contractor under this contract or otherwise, for use in the pre-
[fol. 26] ceding quarter of facilities of the kind mentioned in paragraph (a)(iv) above and facilities and supplies of the kind mentioned in paragraph (a)(v) above, showing separately, the total of such amounts charged to the Government and all of its agencies and the total of such amounts charged to others;

(iv) Reports setting forth such additional information pertaining to this contract as may be required by the Contracting Officer.

Such reports shall be certified by two officers or other responsible officials of the Contractor, one of whom shall be a person supervising accounting with respect to this contract, and shall be deemed to be representations made by the Contractor to the Government for the purpose of inducing the payment of funds to it.

Upon the basis of the information contained in such reports and any other available information, the parties, upon the request of either, agree to negotiate in good faith to determine a revised rate per Payable Hour of Direct Labor for purposes of paragraph (a) of this Article 5, such revised rate to be effective from a date not earlier than the end of the preceding quarter, agreed upon by the parties, and the terms of such agreement shall be incorporated in an amendment to this contract. But if the parties fail to agree within seventy-five (75) days after the end of the preceding quarter, the revised rate for the applicable quarter shall be determined by the Secretary of the Navy after consideration of the recommendation of a Board composed of one representative each of the Secretary of War, the Secretary of the Navy and the Administrator, War Ship-
[fol. 27] ping Administration; such revised rate shall be incorporated promptly in an amendment to this contract.

In determining the amount of the Contractor's indirect expense there shall be deducted ten-elevenths (10/11) of an amount equal to all charges by the Contractor under Government contracts for the repair and alteration of vessels of the nature described in paragraph (a) (iv) of this Article 5, less all rentals paid to the Government on dry-dock and marine railway facilities under a Navy Department facilities contract or on waterfront facilities under a Maritime Commission or War Shipping Administration contract or lease, and ten-elevenths (10/11) of all charges by the Contractor under Government contracts for the repair and alteration of vessels of the nature described in paragraph (a)(v) of this Article 5. There shall also be deducted one-eleventh (1/11) of all moneys paid by the Contractor to the Government or any of its agencies for premiums of policies of insurance covering any risk, hazard or liability of the Contractor arising out of or in connection with this contract and an amount equal to one-eleventh (1/11) of all moneys paid by the Contractor to the Government and allocable to this contract for rental of facilities other than drydocks and marine railways under a Navy Department facilities contract, or waterfront facilities under a Maritime Commission or War Shipping Administration contract or lease.

(e) The Contractor will, by tax exemption certificates or otherwise, eliminate all taxes on material purchased for work hereunder to the extent practicable, and will to the [fol. 28] extent of its ability take all cash and trade discounts, rebates, allowances, credits, salvage, and commissions, and when unable to take advantage of such benefits it shall promptly notify the Naval Cost Inspector to that effect and the reason therefor. In determining the net cost of materials and services of every kind required for the performance of this contract, there shall be deducted from the gross cost thereof all such benefits which have accrued to the Contractor or which would, except for the fault or neglect of the Contractor, have so accrued; but such benefits lost without fault or neglect on the part of the Contractor, or lost because of the fault of the Government, including failure to pay the Contractor within the

time required by this contract, shall not be deducted from such gross cost. If the Contractor, after having been reimbursed, either directly or indirectly, by the Government for any item of services, material or overhead, subsequently receives any additional sum as a discount, rebate, allowance, credit, salvage or commission in respect of any such item, the Contractor shall promptly pay to the Government an amount equal to eleven-tenths (11/10) of such additional sum.

(f) The Contractor agrees to make every effort to complete the work under this contract in the shortest time possible by working shifts if practicable and by taking all other practicable steps to such end; but extra compensation for overtime work at the rate of double time will be payable only where the performance of overtime work at the rate of double time has been authorized in writing by the Naval Inspector in advance of the preformance of such overtime work; provided, however, that the Contractor shall not be required to perform overtime work at the rate [fol. 29] of double time unless such overtime work has been authorized by the Naval Inspector. No allowance shall be made for straight time, overtime, shift work, allowances for lunch periods and rest periods required by law, travelling time or dirty work premiums or incentive bonuses or any other type of payment, in excess of the applicable Zone Standard Agreement or applicable laws and executive orders.

(g) The Contractor shall submit monthly, and may submit at more frequent intervals when the amount payable hereunder for which an invoice or voucher has not been previously submitted exceeds $5,000, an invoice or voucher to or as directed by the Naval Cost Inspector, in as many copies as may be required by the Naval Cost Inspector. Each invoice or voucher may cover amounts accrued here-

under for which an invoice or voucher has not been previously submitted. There shall be set forth in each invoice or voucher or in a schedule attached thereto, a summarization of the amounts in each of the classifications provided in paragraph (a) of Article 5, separately stated for each

vessel. In addition, repair charges and completion, alteration or addition charges shall be separately stated for each vessel. Payment shall be made of the amount of each such invoice or voucher subject to reduction by amounts for which the Contractor is not entitled to payment hereunder and by amounts which are not accepted by the Naval Cost Inspector as chargeable under paragraph (a) of Article 5, and shall also be subject to reduction for overpayments or to increase for underpayments on preceding invoices and vouchers. The Naval Inspector may, in his discretion, [fol. 30] reserve or withhold a part (not exceeding 10%) of each payment for work on any vessel until the satisfactory completion of all job orders on such vessel, or until the agreement upon or determination of the price for work upon such vessel if notice has been given as provided in paragraph (b) of this Article 5. Payment shall be made within fifteen (15) days after receipt of a properly approved and certified invoice or voucher but no interest shall accrue on such payments if delayed. Payments provided for in this paragraph shall be made by the Assistant for Disbursing in the Office of the Supervisory Cost Inspector in the Naval district in which the plant is located; if there is no such Assistant for Disbursing, said payments shall be made by the Disbursing Officer for such Naval District.

Article 6.—Annual Review and Abatement of Charges

(a) Within sixty (60) days after the end of each year the Contractor shall submit to the Contracting Officer a financial statement with respect to its revenues, costs, and profits from the performance of work under this contract during such year. Such statement may cover either work on all vessels on which work is completed during such year or all work billed during such year, depending upon the Contractor's accounting practice consistently followed. Such statement (i) shall be prepared in accordance with the principles outlined in the pamphlet "Explanation of Principles for Determination of Costs under Government Contracts", printed by the U. S. Government Printing Office, April 1942, except paragraph 47, provided that paragraphs 9 and 44 thereof shall be modified to require that [fol. 31] deduction of all cash discounts (without except-

ing 1% cash discounts) and the costs reported shall be subject to the limitations and exclusions described in that pamphlet; (ii) shall be in the form required by the Naval Cost Inspector; and (iii) shall be certified by two officials of the Contractor including the official supervising accounting with respect to this contract. Such statement may be audited with the books and accounts of the Contractor by the Contracting Officer if he so desires.

(b) At the end of any year, or within sixty (60) days after receipt of the Contractor's report under paragraph (a) of this Article, the Contracting Officer may demand that the Contractor repay and the Contractor agrees to repay any profits earned hereunder during such year which are deemed by the Contracting Officer to be in excess of a reasonable profit, provided, that no such demand will be interpreted to require the Contractor to repay an amount

which would reduce the Contractor's profit to less than 10% of the Contractor's cost (excluding from cost and billing for this purpose the cost of furnishing special plant protection under Article 22 hereof; all moneys paid by the Contractor to the Government or any of its agencies for premiums of policies of insurance covering any risk, hazard or liability of the Contractor arising out of or in connection with this contract; the amount paid to the Contractor for furnishing temporary facilities, tools, and equipment and services in connection therewith for which the Contractor has been compensated under Article 5(a)(iii); All rentals paid to the Government under a Navy Department facilities [fol. 32] contract or a Maritime Commission or War Shipping Administration contract or lease; and the amount of all subcontracts with subcontractors affiliated with the Contractor and which have ship repair, completion, alteration and addition contracts with the Government) for such work as determined in accordance with the pamphlet "Explanation of Principles for Determination of Costs under Government Contracts", printed by the U. S. Government Printing Office, April 1942; except paragraph 47 thereof and provided further, that nothing in this paragraph or elsewhere in this contract, shall be construed to limit or

restrict the right of the Government to renegotiate pursuant to Article 29 of this contract or section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, or to affect the amount recoverable in the event of such renegotiation. The Contracting Officer shall certify to the Secretary of the Navy as to the action taken under this paragraph.

Article 7.—Records

(a) The Contractor shall keep adequate records and books of account showing the cost of all items of labor, material, equipment, supplies, services and other expenditures of whatsoever nature in connection with the performance of this contract and records showing the Payable Hours of Direct Labor worked by its employees under this contract. The method of accounting employed by the Contractor shall be subject to the approval of the Government but no material change will be made therein if the same conforms to good accounting practice and is sufficient for the purposes of this contract.

[fol. 33] (b) The Government shall at all times be afforded proper facilities for inspecting records and books of account pertaining to this contract and shall at all times during the regular daytime office hours have access thereto for such purposes. All information obtained from said records and books of account shall be treated as confidential.

(c) The Contractor shall preserve all records and books of account pertaining to this contract, provided, however, that if the Contractor shall desire at any time after six years from the date upon which final payment under this contract becomes due to dispose of said records and books of account, it shall so notify the Government which shall in writing authorize their destruction or notify the Contractor to turn over the same to the Government for such disposal as it may desire to make thereof.

(d) Should the Contractor enter into any subcontract to be performed at the site of the work, including subcontracts for materials, which is incidental to the performance of this contract and such subcontract is on any basis other than a fixed price which may not be adjusted by an escalator clause contained therein, the foregoing pro-

visions of this article shall be applicable to and included in such subcontract.

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Article 8.—Entering and Leaving Dry Dock

(a) The decision as to whether the vessel shall be docked at the appointed time shall vest solely with the commander of the vessel. The commander of the vessel shall approach the dry dock or marine railway in a fair manner and at a [fol. 34] reasonable speed. The commander of a vessel under its own power shall have immediate charge of the vessel until the bow thereof reaches the dry dock sill or the entrance to the marine railway. The dock master shall then take charge and complete the docking, being assisted as necessary by the ship's force until the vessel has been safely docked. In undocking, the dock master shall have charge until the bow of the vessel clears the dry dock sill or the entrance to the marine railway.

(b) The Contractor shall have charge of a vessel not operating under its own power from the time the Contractor's or subcontractor's lines are secured to the vessel until such time as all Contractor's or subcontractor's lines are cast off.

(c) The Contractor shall in each case use its best efforts to have the dry dock or marine railway and other equipment to be used in connection with the repair, completion, alteration or addition of the vessel ready at the scheduled time for the arrival of the vessel.

(d) As an added protection for the Government's interests, and entirely without effect on the Contractor's responsibility for docking and undocking vessels safely, for preventing damage while they are in or on the dock or marine railway, and for making good without charge to the Government such damage as may occur and as is not caused by the Government, the Government shall have, and will normally exercise, the privilege of inspecting the dock or marine railway and the setting of the blocks before a vessel is docked and of requiring repairs or changes to any of the foregoing without charge to the Government when deemed necessary for the vessel's safety. No right to pay- [fol. 35] ment shall accrue to the Contractor for delays in

dockings caused by repairs or changes resulting from the exercise of this privilege.

Article 9.—Plans, Specifications, and Manner of Doing Work

(a) Work shall be performed hereunder in accordance with the job orders and the plans and specifications if any thereunder, and as required or permitted by the Naval Inspector.

(b) The material and workmanship shall represent the best commercial marine practice, except that with regard to military features including gun-foundations, gun-firing mechanisms, torpedo-tube installations, signal apparatus and magazines, Naval standards of material and workmanship shall be followed. The Naval Inspector will prescribe the Naval standard wherever applicable, and the decision of the Naval Inspector shall be final. All work and material shall be subject to the approval of the Naval Inspector.

(c) All material and workmanship shall be subject to inspection and test at all times, to determine their quality and suitability for the purpose intended. In case any material or workmanship is found to be defective, or not in conformity with the specifications or requirements, the Naval Inspector shall have the right to reject such material or workmanship, and to require its correction or replacement by the Contractor. The Contractor shall be paid ten-elevenths (10/11) of the amount provided in paragraph (a) of Article 5 hereof for effecting such correction or replacement. If the Contractor fails to proceed promptly with the replacement or correction of such material or workmanship as required by the Naval Inspector, the Government may, [fol. 36] by contract or otherwise, replace or correct such material or workmanship and charge to the Contractor the excess cost occasioned the Government thereby.

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(d) No welder shall be permitted on work in connection with repairs, completion, alterations or additions unless his qualifications satisfy the Naval Inspector and he is certified by the Bureau of Marine Inspection and Navigation, or American Bureau of Shipping, or he has passed the Navy

test for welders. Likewise, welding electrodes and welding technique used shall be satisfactory to the Naval Inspector. All welding on boilers and high pressure steam lines shall be in accordance with the rules of the Bureau of Marine Inspection and Navigation.

(e) The Contractor shall exercise reasonable care to protect the vessel from fire under the prevailing circumstances. To this end the Contractor shall maintain a reasonable system of inspection over the activities of welders, burners, riveters, painters, plumbers and similar workers, particularly where such activities are undertaken in the vicinity of the vessel's magazines, fuel oil tanks or storerooms containing inflammable materials. Hose lines shall be maintained in such number and as required by the Naval Inspector between the vessel and the shore ready for immediate use at all times while the vessel is berthed alongside the Contractor's pier or in dry dock or on marine railway. All tanks under alteration or repair shall be cleaned, washed and steamed out by the Contractor as may be necessary and the Naval Inspector shall be furnished with a gas-free certificate before any work is done on a [fol. 37] tank. The Contractor shall maintain a fire watch on the vessel at all times which shall be satisfactory to the Naval Inspector.

(f) The Contractor shall place proper safeguards for the prevention of accidents, and shall put up and keep at night suitable and sufficient lights where necessary during the prosecution of the work and use its best efforts to prevent accidents or injury to persons or property.

(g) When the vessel is in the Contractor's custody and the temperature becomes as low as thirty-five (35) degrees Fahrenheit, the Contractor shall keep all pipelines, fixtures, traps, tanks, and other receptacles on the vessel drained to avoid damage from freezing, or if this is not practicable, the vessel shall be kept heated to prevent such damage. The vessel's stern tube and propeller hubs shall be protected from frost damage by applied heat through the use of a salamander or other proper means.

(h) The work shall, whenever practicable, be performed in such manner as not to interfer with the berthing and messing of naval personnel attached to the vessel under-

going repairs or alterations, and provision shall be made so that personnel assigned to duty on the vessel undergoing repairs, completion, alterations or additions shall have access to the vessel at all times, it being understood that such personnel will not interfere with the work or the Contractor's workmen.

(i) The Government does not guarantee the correctness of the dimensions, sizes and shapes given in any job order, sketches, drawings, plans or specifications prepared or furnished by the Government. The Contractor shall be responsible for the correctness of the shape, sizes and dimensions [fol. 38] of parts to be furnished hereunder other than those furnished by the Government.

(j) Any question regarding or arising out of the interpretation of a job order or plans or specifications thereunder or any discrepancy between the plans and specifications shall be determined by the Naval Inspector.

(k) While in dry dock or on marine railway the Commander of the vessel shall be responsible for the proper closing of all openings to the ship's bottom upon which no work is being done by the Contractor's workmen. The Contractor shall be responsible for the closing, before the

end of working hours, of all valves and openings upon which work is being done by its workmen when such closing is practicable. The Contractor shall keep the Commander of the vessel cognizant of the closure status of all valves and openings upon which the Contractor's workmen have been working.

(l) The Government will furnish materials, supplies, tools, equipment, plans and drawings and facilities and services as determined by the Naval Inspector.

(m) The Contractor shall indemnify and save harmless the Government and its agencies and instrumentalities, the vessel and the owner of the vessel, from all suits or actions and damages or costs of every name and description to which the Government and its agencies and instrumentalities, the vessel or the owner thereof may be subject or put by reason of injury (including death) to the person or [fol. 39] property of another arising or growing out of the

fault or negligence of the Contractor or any subcontractor, its or their servants, agents or employes.

Article 10.—Subcontracts

(a) Prior to the letting of each subcontract hereunder and the placing of each order for the purchase of direct materials hereunder the Contractor shall give the Naval Inspector notice of its intention of so doing, and shall comply with any and all requirements which may be imposed by the Naval Inspector as to the extent to which and the terms and conditions upon which such subcontract or order shall or may be made.

(b) In addition to such other requirements as may be imposed by the Naval Inspector or under the terms of this agreement every subcontract and order made by the Contractor in performance hereof shall contain provisions which will fulfill the requirements of Article 7, 10(a), 13, 19, 21, 23, 24, 25, 26, and 29 hereof to the extent the requirements of such articles are applicable.

(c) If work of a nature which is ordinarily done under a ship repair or alteration contract and materials in connection with such work are done or furnished for work hereunder, by a subcontractor (including a subcontractor which is affiliated with the Contractor) which has a ship repair, completion alteration or addition contract with the Government, all such work and materials shall be charged to the Government under this contract at a price not in excess of that payable for doing such work or furnishing such material if furnished directly to the Government under such other ship repair, completion, alteration or addition contract. If work is done by a subcontractor who has a [fol. 40] ship repair, completion, alteration or addition contract with the Government, the work shall, except as may be mutually agreed by the parties hereto, be done at rates not in excess of the rates payable under such contract.

Article 11.—Risk of Loss; Insurance

(a) The Government assumes the risk of loss of or damage (including, but not limited to loss or damage from negligence of whatsoever degree, of the Contractor's servants, employees, agents or subcontractors) to vessels, title

to which is in the Government, and the equipment, movable stores and cargo of such vessels, and all materials or equipment in the possession of the Contractor, title to which is in the Government. Unless otherwise agreed in writing, the Contractor's aggregate liability with respect to vessels, title to which is not in the Government, shall in no event exceed the sum of $300,000, for each vessel, its equipment, movable stores and cargo, and the Government assumes any

liability of the Contractor for loss or damage thereto in excess of such sum. The Government shall secure the issuance by the War Shipping Administration under Public Law 17, 78th Congress of a policy or policies of insurance insuring the Contractor, in excess of such sum, on War Shipping Administration form "Warship-Repair".

The Cost to the Contractor of all ship repairer's legal liability insurance in excess of that indemnifying the Contractor against the liability provided for above shall be deducted in determining the amount of the Contractor's indirect expense under Article 5 hereof. The Chief of [fol. 41] the Bureau of Ships may require the Contractor to provide evidence of valid and satisfactory insurance in an amount equal to the sum set forth above, or otherwise agreed upon as above provided, with respect to each vessel, title to which is not in the Government, indemnifying the Contractor against liabilities for loss or damage to the vessel or its equipment, movable stores or cargo.

The Contractor shall procure and thereafter maintain insurance in such form, in such amounts, and at such rates as may be required or approved by the Chief of the Bureau of Ships insuring against the Contractor's third party liability for loss, damage or injury (including death) to a person or property of another (other than liability for loss of or damage to vessels being repaired under a ship repair, completion, alteration or addition contract with the Government and their respective equipment, movable stores and cargo and other than liability to employees of the Contractor or a subcontractor) arising out of performance by the Contractor hereunder. The Government shall cause the War Shipping Administration to issue a policy or policies

of insurance insuring the Contractor against such third party liability arising out of or in connection with work done hereunder at a location other than the plant in an amount not exceeding the difference between the insurance against such third party liability otherwise obtained by the Contractor and $ *None Required.*

(b) As soon as practicable after the occurrence of any event from which the obligation of the Government to hold the Contractor harmless against loss, expense, or liability might arise, written notice of such event shall be given by the Contractor to the Government, which notice shall con- [fol. 42] tain full particulars of such event. If claim is made or suit is brought thereafter against the Contractor as the result or because of such event the Contractor shall immediately deliver to the Government every demand, notice, summons, or other process received by it or its representatives.

(c) The Contractor shall cooperate with the Government and, upon the Government's request, shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits; and the Government shall pay to the Contractor the expense, other than the cost of maintaining the Contractor's usual organization, incurred in so doing. The Contractor shall not, except at its own cost, voluntarily make any payment, assume any obligation or incur any expense other than shall be imperative for the protection of the vessel or vessels at the time of said occurrence of such event.

(d) This undertaking of the Government to hold the Contractor harmless against loss, expense, and liability, as herein provided, shall not create or give rise to any right, privilege, or power, in any person or organization, except the Contractor, nor shall any person or organization be or become entitled to join the Government as a co-defendant in any action against the Contractor brought to determine the Contractor's liability or for any other purpose; provided, however, that as to any risk borne or assumed by the Government through this undertaking above set forth, the Government shall be subrogated to any claim, demand or cause of action against third persons or organizations [fol. 43] which exist in favor of the Contractor, and the

Contractor shall, if required, forthwith execute formal assignments or transfers of such claims, demands or causes of action.

Article 12.—Guarantees

(a) The Contractor shall promptly repair or replace any damage to or defect in the vessel, its machinery or equipment resulting from or becoming apparent during the course of any dock trial or sea trial given the vessel hereunder, which damage or defect is determined by the Naval Inspector to be due to faulty design or workmanship on the part of the Contractor, or to faulty material furnished by the Contractor. The Contractor shall be paid ten-elevenths (10/11) of the amount provided in paragraph (a) of Article 5 hereof for effecting such repair or replacement.

(b) In case any work done or material furnished under this contract on or for any vessel or the equipment thereof shall, within sixty (60) days from the date of completion of all work thereon by the Contractor, prove defective or deficient, except as a result of ordinary wear and tear, such defects or deficiencies shall as required by the Government be corrected and repaired by the Contractor at its plant or at any other plant of the Contractor to the satisfaction of the Naval Inspector. The Contractor shall be paid for effecting such correction and repair ten-elevenths (10/11) of the amount provided in paragraph (a) of Article 5 of the contract in effect at the plant where such corrections and repairs are made.

[fol. 44] Article 13.—Title

(a) Title to all material and equipment to be incorporated in the vessel or its equipment or to be used in doing any work hereunder or in connection therewith shall vest in the Government as payment is made therefor by the Government or by the Contractor, or upon delivery thereof to the Government or to the Contractor, whichever of said events shall first occur.

(b) The Contractor shall, as soon as practicable, identify any property which is to become a part of the vessel by

marking or segregation in such a way as to indicate ownership thereof by the Government and its allocation to the vessel.

(c) Nothing contained in this Article shall relieve the Contractor of any of its duties or obligations under this contract or constitute any waiver of the Government's rights to require fulfillment of all of the terms hereof.

Article 14.—Liens

The Contractor shall pay all costs and expenses incident to any work performed by it or for its account, and shall not have any right, power or authority to and shall not create, incur, suffer or permit to be placed or imposed upon any vessel being repaired, its hull, engines, tackle, apparel and furniture of all kinds, any maritime lien or other lien or any encumbrance or charge in any way arising from any act or omission of the Contractor, or to incur any debt, obligation or charge upon the credit of the vessel. The Contractor shall, orally or in writing, inform all persons dealing with it of the provisions of this paragraph.

[fol. 45] Article 15.—Transfer or Assignment of Contractor's Claims

(a) Neither this contract, nor any interest herein except as otherwise provided in this Article, shall be transferred by the Contractor to any other party or parties.

(b) Claims for moneys due or to become due to the Contractor from the Government arising out of this contract may be assigned to any bank, trust company, or other financing institution, including any Federal lending agency. Any such assignment shall cover all amounts payable under this contract and not already paid, shall not be subject to further assignment, and shall not be made to more than one party, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in the financing of this contract. In the event of any such assignment, the assignee thereof shall file writ-

ten notice of the assignment together with a true copy of the instrument of assignment with (1) the General Accounting Office of the Government, (2) the Chief of the Bureau of Ships, (3) the surety or sureties upon the bond or bonds, if any, in connection with this contract, and (4) the disbursing officer designated to make payments under this contract.

(c) Payments to an assignee of any claims arising under this contract shall not be subject to reduction or set-off for any indebtedness of the Contractor to the Government arising independently of this contract.

[fol. 46] (d) Information contained in plans, specifications, or any similar document, relating to work under this contract and marked "Secret", "Confidential", or "Restricted", shall not, in connection with assignment of any claim under the contract, be communicated, transmitted, or disclosed to any person not otherwise entitled to receive it, except with the prior consent of the Chief of the Bureau of Ships in each instance.

Article 16.—Patents

(a) The Contractor shall hold and save the Government, its officers, agents, servants, and employees, harmless from patent liability of any nature or kind, including costs and expenses, for or on account of any patented or unpatented invention made or used in the performance of this contract, including the use or disposal thereof by or on behalf of the Government; provided, that the foregoing shall not apply to inventions covered by applications for United States Letters Patent which, during the term of this contract, are being maintained in secrecy under the provisions of Title 35, U. S. Code (1940 ed.), section 42, as amended; provided further, that this Article is not, and shall not be construed to be, applicable to any infringement of United States Letters Patent which results from the Contractor complying with specific written instructions furnished by the Government, or where infringement is occasioned by the use of an apparatus patent due to the fabrication, installation, or operation of apparatus in accordance with plans or specifications furnished to the Contractor by the Government

or from the use or disposition of material or apparatus furnished to the Contractor by the Government.

[fol. 47] (b) The Contractor shall promptly notify the Government in writing of any known infringement and all claims of infringement relating to this contract that may be brought to the Contractor's attention; and in case of litigation on account thereof, the Contractor shall assist the Government at the latter's expense, save for services of the Contractor's employees, in furnishing such evidence as to the use of patents and other matters of fact as may be required by the Government in such litigation.

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Article 17.—Stipulations Under Walsh-Healey Act

There is hereby incorporated herein by reference the representations and stipulations pursuant to Public Act No. 846, Seventy-Fourth Congress, as set forth in Article I of Part I of Regulations No. 504, issued by the Secretary of Labor pursuant to such Act, as from time to time amended.

Article 18.—Workmen's Compensation Insurance

During the life of this contract the Contractor will provided and maintain, for all employees of the Contractor engaged in work under this contract, such Workmen's Compensation insurance or such other protection for employees as may be required by Federal or State statutes in the jurisdiction in which such work is performed, under the direction of the Contracting Officer.

Article 19.—Nonrebate

The Contractor shall comply with the regulations of the Secretary of Labor under the Copeland Act of June 13, 1934 (40 U. S. Code (1940 ed.) secs. 276b and 276c), [fol. 48] entitled "Regulations Applicable to Contractors and Subcontractors on Public Building and Public Work and on Building and Work Financed in Whole or in Part by Loans or Grants from the United States" (7 F. R. 687, 925, 2591, 3358) and any amendments or modifications thereof, and shall insert in subcontracts appropriate pro-

visions requiring compliance therewith by all subcontractors subject thereto, except as the Secretary of Labor may specifically provide for reasonable limitations, variations, tolerances, and exemptions from the requirements of said regulations.

Article 20.—Convict Labor

The Contractor shall not employ any person undergoing sentence of imprisonment at hard labor.

Article 21.—Nondiscrimination in Employment

(a) The Contractor hereby agrees that, in performing the work required by this contract, it will not discriminate against any employee or applicant for employment because of race, creed, color, or national origin.

(b) The Contractor hereby agrees that a provision identical with paragraph (a) above will be included in all of its subcontracts.

(c) For the purpose of this article, subcontracts shall be deemed to include all purchase orders and agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of this contract, except purchase orders or agreements for the furnishing of standard commercial articles or raw materials.

[fol. 49] Article 22.—Plant Protection

(a) In addition to taking the ordinary precautions heretofore adopted by the Contractor for the guarding and protection of its plant and work, the Contractor shall provide, as may be required or approved by the Contracting Officer, special plant protection such as additional equipment, devices and watchmen for the protection of its plant and property and the work in process for the Government against espionage, sabotage or enemy action.

(b) When directed by the Naval Inspector, the Contractor shall deliver to the Naval Inspector a list of items of additional plant protection deemed necessary for adequate plant protection, together with an estimate of the cost thereof. Such items of additional plant protection shall be

those required by the circumstances under which this contract is being performed and must be directed against espionage, acts of war and acts of enemy aliens. The Contractor must provide without charge protection against the elements, including storms and high water, and take the precautions usually taken as prudent measures in shipbuilding or manufacturing plants against fire, theft, and other risks such as occur in the ordinary conduct of business.

(c) If approved by the Naval Inspector, such list, together with the estimate of cost and the comments of the Naval Inspector, shall be forwarded to the Contracting Officer in triplicate for approval. If the Contracting Officer disapproves the proposed expenditures for special plant protection, the Contractor and the Naval Inspector will be so informed by letter. If such proposed expenditures are approved, the Contracting Officer shall issue a letter author- [fol. 50] izing such special plant protection. The cost to the Contractor, as determined by the Special Board on Changes of the Navy Department, of all safeguards so required or approved shall be reimbursed to the Contractor. Such costs shall not include any allowance on account of overhead expense except shop overhead charges incident to the construction or installation of such devices or equipment.

(d) Upon payment by the Government of the cost to the Contractor of any equipment or device required or approved under paragraph (a) of this Article, title thereto shall vest in the Government, and the Contractor shall comply with the instructions of the Navy Department respecting the identification and disposition thereof. No part or item of any such devices or equipment shall be or become a fixture by reason of affixation to any realty not owned by the Government.

Article 23.—Disclosure of Information

(a) It is understood that the work contracted for hereunder relates to and is connected with the national defense (the prosecution of the war effort), and it is agreed: (1) That no information relating to the work under this contract shall be communicated, transmitted, or disclosed to any person not entitled to receive it; and (2) that the

Contractor shall be responsible for safeguarding matters within the Contractor's control identified by the Navy Department as Secret, Confidential or Restricted.

(b) Information contained in the plans and specifications may be disclosed to the officers, agents, or employees of the Contractor to the extent that such disclosure is essential [fol. 51] to the performance of this contract, subject to any restrictions which may be imposed by the Contracting Officer of the Naval Inspector. Information contained in the plans and specifications may be disclosed to officers, agents, or employees of corporations, partnerships or persons undertaking the performance of subcontracts or purchase orders made or placed under this contract only if the Contracting Officer or the Naval Inspector shall consent to such disclosure.

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(c) It is further understood that disclosure of information relating to the work contracted for hereunder to any person not entitled to receive it, or failure to safeguard all matters within the Contractor's control identified by the Navy Department as Secret, Confidential or Restricted, may subject the Contractor, his or its agents, employees, and subcontractors, to criminal liability under the laws of the United States, including Title I of an Act approved June 15, 1917 (Public No. 24, 65th Congress; 40 Stat. 217), as amended by an Act approved March 28, 1940 (Public No. 443, 76th Congress; 54 Stat. 79) (50 U. S. Code (1940 ed.) Chap. 4), and the provisions of an Act approved January 12, 1938 (Public No. 418, 75th Congress: 52 Stat. 3; 50 U. S. Code (1940 ed.) 45-45d), as supplemented by Executive Order No. 8381 dated March 22, 1940.

Article 24.—Alien Employees of Contractor and Subcontractor

(a) The plans and specifications under this contract are identified by the Navy Department as Confidential within the meaning of Section 11 of 54 Stat. 676 (Public No. 671, [fol. 52] 76th Congress), and it is agreed that no aliens in the employ of the Contractor shall be permitted to have access to the plans or specifications or the work under the

contract or to participate in the contract trials unless the written consent of the Secretary of the Navy has first been obtained.

(b) In each subcontract or purchase order which the Contractor may make or place under this contract there shall be included a stipulation that no aliens in the employ of the corporation, partnership, or other person undertaking the performance of the subcontract or purchase order shall be permitted to have access to the plans or specifications, or the work under the contract, or to participate in the contract trials, unless the written consent of the Secretary of the Navy has first been obtained; provided, that such stipulation need not be included in any subcontract or purchase order for standard or commercial products procured under specifications which will not disclose the nature or character of the subject matter of this contract or any other information relative thereto which has been identified by the Government as Secret, Confidential or Restricted; provided further, that such stipulation need not be included in a subcontract or purchase order if the Contracting Officer or the Naval Inspector shall consent to the omission of such stipulation from such subcontract or purchase order or to the inclusion of a different stipulation therein.

Article 25.—Report of Espionage, Sabotage or Subversive Activities

(a) The Contractor agrees that it will immediately submit a confidential report to the Navy Department or its duly authorized representatives, with copies to such other [fol. 53] Government agencies as the Navy Department or its duly authorized representatives may designate, whenever it has information indicating (1) that any of its employees may be engaged in subversive activity at any place or (2) that an active danger of espionage or sabotage exists at any plant, factory or site at which work under this contract is being performed or at which material acquired, fabricated or manufactured in connection with the performance of this contract is stored. The reports shall contain a complete statement of such information. The Contractor agrees that it will instruct its personnel to submit any

information coming to their attention with respect to the foregoing.

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(b) The Contractor agrees that it will, whenever directed by duly authorized representatives of the Navy Department, submit any and all information which the Contractor may have concerning any of its employees engaged in work at any plant, factory or site at which work under this contract is being performed.

(c) The Contractor agrees that it will refuse to employ, or if already employing will forthwith discharge from employment and will exclude from any plant, factory or site at which work under this contract is being performed, any person or persons whom the Secretary of the Navy or his duly authorized representatives, in the interest of security against espionage, sabotage or subversive activity may designate.

(d) In each subcontract or purchase order which the Contractor may make or place under this contract the [fol. 54] Contractor shall include stipulations which shall conform substantially to the language of the preceding paragraphs of this Article; provided, that such stipulations need not be in any subcontract or purchase order for standard or commercial products procured under specifications which will not disclose the nature or character of the subject matter of this contract; provided further, that such stipulations need not be included in a subcontract or purchase order if the Contracting Officer or the Naval Inspector shall consent to the omission of such stipulations or the inclusion of different stipulations.

Article 26.—Officials Not to Benefit

No member of or delegate to Congress or Resident Commissioner shall be admitted to any share or part of this contract or to any benefit that may arise therefrom, but this provision shall not be construed to extend to this contract if made with a corporation for its general benefit.

Article 27.—Covenant Against Contingent Fees

The Contractor warrants that it has not employed any person to solicit or secure this contract upon any agree-

ment for a commission, percentage, brokerage or contingent fee. Breach of this warranty shall give the Government the right to annul the contract, or, in its discretion, to deduct from the contract price or consideration the amount of such commission, percentage, brokerage, or contingent fees. This warranty shall not apply to commissions payable by contractors upon contracts or sales secured or made through bona fide established commercial or selling agencies [fol. 55] maintained by the Contractor for the purpose of securing business.

Article 28.—Disputes

Except as otherwise specifically provided in this contract, all disputes concerning questions of fact which may arise under this contract or on any job order, or plans or specifications, and which are not disposed of by mutual agreement, shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail a copy thereof to the Contractor by registered mail. Within thirty (30) days from said mailing the Contractor may appeal to the Secretary of the Navy, whose decision or that of his duly designated representative, or representatives, or board shall be final and conclusive upon the parties hereto. No claim by the Contractor arising under this contract with respect to any vessel shall be considered unless submitted in writing within six (6) months from the date of completion of the repairs and alterations on such vessels or her equipment by the Contractor, or within such longer period as the Secretary of the Navy may approve in writing. Pending decision of a dispute hereunder the Contractor shall diligently proceed with the performance of this contract.

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Article 29.—Renegotiation

Pursuant to Sec. 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended:

(a) Upon the written request of the Secretary of the Navy at such period or periods when in the judgment of [fol. 56] the Secretary of the Navy the profits accruing under this contract can be determined with reasonable cer-

tainty, the contract price shall be renegotiated to eliminate therefrom such amount as is found as a result of such renegotiation to represent excessive profits.

(b) Any profits found as a result of such renego-tion to be excessive and not eliminated through reductions in the contract price hereunder or otherwise shall, as the Secretary of the Navy may direct, (1) be retained by the Government from amounts otherwise due the Contractor, or (2) be repaid by the Contractor to the Government, if such excessive profits have been paid to the Contractor.

(c) The Contractor shall require the insertion of the following provisions in each subcontract described in subparagraph (f)(2)(ii) of this Article and in each subcontract for an amount in excess of $100,000 described in subparagraph (f)(2)(i) of this Article, directly entered into by the Contractor under this contract.

(1) Upon the written request of the Secretary of the Navy at such period or periods when in the judgment of the Secretary the profits accruing under this contract can be determined with reasonable certainty, the contract price shall be renegotiated by the Secretary of the Navy and [1] ..... to eliminate therefrom such amount as is found as a result of such renegotiations to represent excessive profits.

(2) Any profits found as a result of such renegotiation to be excessive and not eliminated through reductions in the contract price hereunder or otherwise, shall, as the Secretary of the Navy may direct, (i) be retained by [2] ..... for the Government, or (ii) be repaid by [1] ..... to the Government, if [fol. 57] such excessive profits have been paid to [1] .....

(3) [2] ..... is hereby relieved from any liability to [1] ..... on account of any amount retained or repaid pursuant to paragraph (2) above.

(4) [1] ..... shall, upon the direction of the Secretary of the Navy, require the insertion in any

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[1] Subcontractor.

[2] Contractor.

subcontract made hereunder, of contract provisions conforming substantially to the provisions of this Article.

(5) Any renegotiation under this Article shall be conducted pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended.

(6) The Contractor shall also require the insertion of the definitions which are contained in subparagraph (f) of this Article in each such subcontract.

(d) Any profits under any subcontract hereunder which are found as a result of renegotiation to be excessive and which the Contractor is directed by the Secretary of the Navy to withhold from payments otherwise due the subcontractor and actually unpaid at the time of receipt of

such direction, shall, as the Secretary of the Navy may direct, (1) be retained by the Government from amounts otherwise due the Contractor, or (2) be repaid by the Contractor to the Government.

(e) Any renegotiation under this Article shall be conducted pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended.

(f) For the purpose of this Article,

[fol. 58] (1) the terms "Secretary of the Navy" and "Secretary" shall be deemed to include any authorized representative of the Secretary of the Navy, and

(2) the term "subcontract" means (i) any purchase order or agreement to perform all or any part of the work or to make or furnish any article, required for the performance of any other contract or subcontract, unless exempted from the provisions of Section 403, as amended, under subsection (i) thereof, or (ii) any contract or arrangement (other than a contract or arrangement between two contracting parties, one of which parties is found by the Secretary of the Navy to be a bona fide executive officer, partner, or full-time employee of the other contracting party), (A) any amount payable under which is contingent upon the procurement of a contract or contracts with the

Navy Department or of a subcontract or subcontracts thereunder; or determined with reference to the amount of such a concontract or subcontract or such contracts or subcontracts or (B) under which any part of the services performed or to be performed consists of the soliciting, attempting to procure, or procuring a contract or contracts with the Navy Department or a subcontract or subcontracts thereunder. The term "article", as used in this definition, includes any material, part, assembly, machinery, equipment, or other personal property.

Article 30.—Cancellation and Termination

(a) Cancellation:

Any job order hereunder may be cancelled in whole or in part at the option of the Naval Inspector by written [fol. 59] notice to the Contractor. In the event of such cancellation, the Contractor shall:

(i) Comply with such notice by stopping work under such job order at the time and to the extent required by such notice and by cancelling material orders and subcontracts entered into for the performance of such job order;

(ii) Take such steps to protect the interests of the Government and with respect to the care and disposition of the material and equipment pertaining to such cancelled job order and the vessel, as may be necessary and, in addition, as such notice or the Naval Inspector may direct;

(iii) The Contractor shall be paid under Article 5 hereof (A) for work done and material furnished under such job order prior to stopping work under the notice of cancellation, for which the Contractor has not already been

paid pursuant to the provisions of this paragraph (a); and (B) all reasonable costs incurred in cancelling such material orders and subcontracts.

(b) The Naval Inspector may determine that a vessel shall be removed from the Contractor's plant or other premises where it is located. In such event, the Government shall have access to the Contractor's plant or other

premises to the extent necessary or convenient in making the vessel seaworthy and removing the vessel.

(c) Termination:

(i) This contract may be terminated by the Government in whole or in part whenever the Contracting Officer shall determine that termination is for the best interest of the [fol. 60] Government. Termination shall be effected by delivery to the Contractor of a Notice of Termination specifying the cause of termination, the extent to which performance of the contract shall be terminated, and the date upon which termination shall become effective, which date will not be earlier than the date of the receipt of the Notice of Termination;

(ii) After receipt of the Notice of Termination, the Contractor shall:

(1) Terminate work on the contract on the date and to the extent specified in the Notice of Termination;

(2) Submit to the Naval Inspector within thirty (30) days after receipt of Notice of Termination, a list of all unperformed orders and subcontracts relating to this contract;

(3) Place no further orders for materials or equipment except as may be directed by the Naval Inspector;

(4) Cancel and terminate all orders and subcontracts not necessary for the performance of any work required to be performed under the Notice of Termination;

(5) Assign to the Government all of the right, title and interest of the Contractor under such orders or subcontracts as the Contracting Officer may direct;

(6) Transfer title to and deliver to the Government, in the manner and at the times directed by the Naval Inspector such of the plans, drawings, materials, fabricated parts, work in process and completed work relating to the performance of this contract, as the Contracting Officer may direct. Such items shall be covered by a job order prepared and executed as provided in Article 3 hereof;

[fol. 61] (7) Complete performance of such part of the contract as shall not have been terminated by the Notice of Termination; and

(8) Take such action as the Naval Inspector may direct

for the protection and preservation of the property in the possession of the Contractor and in which the Government has an interest.

(iii) After termination of this contract in the manner provided in this Article, the Government shall pay to Contractor, within a reasonable time after such termination, the following:

(1) The amount due the Contractor in accordance with Article 5 hereof under job orders for work done and materials furnished to the time of termination and for work and materials required by the Naval Inspector to be furnished after termination;

(2) Any reasonable expense incidental to termination under paragraph (ii) hereof, of orders or subcontracts;

(3) The reasonable cost of the preservation and protection of property required under paragraph (ii) hereof.

(iv) The obligation of the Government to make any of the payments required under paragraph (iii) hereof shall be subject to (1) any unsettled claims against the Contractor for labor or materials, (2) any claim which the Government may have against the Contractor, (3) deductions for any advance payments, unit payments, or partial payments made to the Contractor under or in connection with this contract, and (4) reasonable deductions by the Government on account of defects in the materials or workmanship of [fol. 62] completed or partially completed work hereunder or other defaults under this contract.

(v) Termination under this Article 30(c) shall affect the provisions of and obligations under this contract only to the extent specified in this Article or in the Notice of Termination or necessarily implied thereby and shall not affect any other rights or obligations which the parties hereto may have under contract or commonlaw or under any statute. The payments required by this Article 30(c) shall be in full satisfaction and constitute a discharge of all claims by the Contractor to damages or compensation arising out of termination except as otherwise expressly agreed. The Contractor shall give the Government a release or releases in such form as required by the Contracting Officer.

(vi) The Contractor shall have the right to terminate this contract by giving the Contracting Officer notice thereof in writing. The contract shall terminate forty-five (45) days after receipt of such notice by the Contracting Officer except with respect to all work on vessels which are delivered to the Contractor prior to the expiration of the aforementioned forty-five (45) days.

Article 31.—Definitions

For the purposes of this contract, the term "Naval Inspector" is defined as the authorized representative of the Chief of the Bureau of Ships, the term "Naval Cost Inspector" is defined as the officer in charge of the Cost Inspection Division of the Bureau of Supplies and Accounts; and the term, "Secretary of the Navy", "Chief of the Bureau of Ships", "Contracting Officer", "Naval Inspector", and [fol. 63] "Naval Cost Inspector" include in each case their respective successors and authorized representatives.

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Article 32—Period of the Contract

Unless sooner terminated as herein provided, this contract shall within the limits of the appropriations available therefor remain in force during the continuance of the present war and for six months after the termination of the war.

Article 33

The following new subsection is added at the end of Article 5(a):

(vi) The increase in wages and related tax and insurance costs paid for work done under this contract as a direct result of a retroactive mandatory order of the War Labor Board, but without allowance for either profit or overhead.

The last paragraph of Article 5(d) is changed as follows:

(a) By substituting, in two places, the words and figures "one hundred-one hundred and ninth (100/109)" for the words and figures "ten-elevenths (10/11)".

(b) By substituting, in two places, the words and figures

"nine-one hundred and ninths (9/109)" for the words and figures "one-eleventh (1/11)".

Article 5(e) is changed as follows:

By substituting the words and figures "one hundred and nine-one hundredths (109/100)" for the words and figures "eleven-tenths (11/10)".

Article 9(c) is changed as follows:

[fol. 64] By substituting the words and figures "one hundred-one hundred and ninths (100/109)" for the words and figures "ten-elevenths (10/11)".

Article 12(a) and 12(b) are changed as follows:

By substituting the words and figures "one hundred-one hundred and ninths (100/109)" for the words and figures "ten-elevenths (10/11)".

In witness whereof, the parties hereto have executed this contract as of the day and year first above written.

The United States of America By [s] W. R. Gary, Contracting Officer, Bureau of Ships, Navy Department; Graham Ship Repair Co. (Contractor), By [s] W. C. Graham, W. C. Graham, General Partner.

Two witnesses as to Contractor:
/s/ E. B. MacDonald
E. B. MacDonald
/s/ James Close
James Close

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State of California, County of San Francisco, ss:

On this 6th day of January, 1945, before me personally appeared W. C. Graham, to me known, who, being by me first duly sworn, did depose and say that he is a general partner in the firm of Graham Ship Repair Co.; that said firm consists of himself and A. Bourke, C. Y. Cobb, J. P. Cobb, Metro Adams, Frank Hansen and Louis A. Clausell, all [fol. 65] limited partners; and that he executed the fore-

going instrument on behalf of said firm for the uses and purposes stated herein.

/s/ Dorothy Berger, Dorothy Berger, Notary Public in and for the County of San Francisco, State of California, (Notarial Seal) My Commission expires October 4, 1945.

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Schedule "A"

Rates for drydock, marine railway, floating derrick and tugboat services, referred to in Article 5(a)(iv).

None

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Exhibit 1(A.) to Petition

Navships 2695A

April 45.

Agreement Amending Contract

NObs 10230. (Navy)

This negotiated agreement entered into as of the 1st day of April, 1945, by and between The United States of America (hereinafter called the "Government"), represented by the Contracting Officer executing this agreement and Graham Ship Repair Co., a partnership organized and existing under the laws of the State of California (hereinafter called the "Contractor"),

[fol. 66] Witnesseth:

Whereas, the parties hereto entered into Contract NObs 10230 for the repair, completion, alteration of or additions to vessels (hereinafter called the "Contract"); and

Whereas, the Contracting Officer has determined that this agreement will facilitate the prosecution of the war; and

Whereas, the parties desire to amend the Contract in the respect hereinafter set forth;

Now, therefore, the parties hereto mutually agree as follows:

Article I. The Contract is hereby amended in the following respects (the Article numbers refer to the Article numbers in the Contract, as amended):

1. The entire text of Article 6 (b) is amended to read as follows:

"(b) At the end of any year or within sixty (60) days after receipt of the Contractor's report under paragraph (a) of this Article, the Contracting Officer may demand that the Contractor repay, and the Contractor agrees to repay any profits earned hereunder during such year which are deemed by the Contracting Officer to be in excess of a reasonable profit; provided, that no such demand will be interpreted to require the Contractor to repay an amount which would reduce the Contractor's profit to less than the following percentages of the Contractor's aggregate costs under all the master time and material vessel repair contracts between the Contractor and the War Department, the Navy Department, and the Administrator, War Shipping Administration, respectively:

"(i) If costs under said contracts during such year aggregate no more than $4,000,000, then in excess of 7% of costs;

[fol. 67] "(ii) If costs under said contracts during such year aggregate more than $4,000,000 but not more than $25,000,000, then in excess of 7% of costs for the first $4,000,000 in costs and in excess of 6½% of costs for the balance of the costs; and

"(iii) If costs under said contracts during such year aggregate more than $25,000,000, then in excess of 6½% of costs for all costs, including the first $4,000,000.

"The Contractor's costs under this contract and under said contracts shall exclude from cost and billing for these purposes the cost of furnishing special plant protection under Article 22 hereof; all monies paid by the Contractor to the Government or any of its agencies for premiums of policies of insurance covering any risk, hazard, or liability of the Contractor arising out of or in connection with this Contract; the amount paid to the Contractor for furnishing temporary facilities, tools, and equipment and services in connection therewith for which the Contractor has been

compensated under Article 5(a)(iii); all rentals paid to the Government under a Navy Department facilities contract or a Maritime Commission or War Shipping Administration contract or lease; and the amount of all subcontracts with subcontractors affiliated with the Contractor and which have ship repair, completion, alteration, and addition contracts with the Government, and shall be determined in accordance with the pamphlet 'Explanation of Principles for Determination of Costs under Government Contracts,' printed by the U. S. Government Printing Office, April 1942, except paragraph 47 thereof; and provided further that nothing in this paragraph, or elsewhere in this contract, except as provided in Article 29(c) hereof, shall be construed to limit or restrict the right of the Gov- [fol. 68] ernment to renegotiate pursuant to Article 29 of this contract or Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, or to affect the amount recoverable in the event of such renegotiation. The Contracting Officer shall certify to the Secretary of the Navy as to the action taken under this paragraph."

2. The entire text of Article 29 is amended to read as follows:

"(a) This contract shall be deemed to contain all the provisions required by subsection (b) of the Renegotiation Act, as amended by Section 701 of the Revenue Act of 1943 (Public Law 235, 78th Congress, enacted February 25, 1944).

"(b) In compliance with said subsection (b) of the Renegotiation Act, the Contractor shall insert in the subcontracts specified in said subsection (b) either the provisions of paragraphs (a) and (b) of this Article or the provisions required by said subsection (b).

"(c) The Secretary of the Navy has found and determined that, in his opinion, the provisions of this contract are, without reference to the exempted provisions of the Renegotiation Act (Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended), otherwise adequate to prevent excessive profits during the year beginning April 1, 1945, and ending March 31, 1946.

Accordingly, notwithstanding Article 29(a) hereof, and pursuant to the authority delegated to the Secretary of the Navy by the War Contracts Price Adjustment Board under date of November 10, 1944, and the authority delegated to the Contracting Officer by the Secretary of the Navy, the Contracting Officer has and does hereby exempt this contract from all of the provisions of the said Renegotiation Act except subsections (b) (3) and (b) (4) thereof, [fol. 69] for the period beginning April 1, 1945, and ending March 31, 1946. This exemption does not extend to any subcontracts, agreements or purchase orders made or placed for the performance of this contract, and accordingly does not affect the provisions of Article 29(b).

3. The following new paragraph is added to Article 30(c):

"(vii) In addition to the right to terminate under Article 30(c)(vi), the Contractor may, at any time when in its judgment it is probable that a sharp and permanent decline in the work load either has occurred or is imminent, give written notice to the Contracting Officer effective fifteen (15) days after its receipt, that it elects to perform all work hereunder which is incomplete on the effective date of the notice and such additional work as may be assigned to the Contractor pursuant to Article 2 hereof for forty-five (45) days thereafter, on a cost-plus-a-fixed-fee basis. In the event of such election by the Contractor (i) the fixed fee to be paid to the Contractor for such incomplete and new work shall be fixed by the Contracting Officer on a basis which he shall determine to be fair and equitable after the Contractor shall have been given an opportunity to be heard by the Contracting Officer; (ii) the Contractor's costs for the completion of such incomplete and new work shall be determined as provided in the pamphlet 'Explanation of Principles for Determination of Costs under Government Contracts' printed by the U. S. Government Printing Office, April 1942, except Paragraph 47, provided that Paragraphs 9 and 44 thereof shall be modified to require the deduction of all cash discounts (without excepting 1% cash discounts) and the costs shall be subject to the limitations and exclusions described in that pamphlet; and

[fol. 70] (iii) except as they conflict with the express provisions of this Paragraph, all of the terms of this contract shall remain in full force and effect with respect to the performance of such incomplete and new work.

"In addition, the Contractor and the Contracting Officer by mutual agreement may convert this contract so that all incomplete and new work shall be performed on such other basis as they may agree, provided that the failure to agree on such other basis shall not be a dispute within the meaning of Article 28 hereof. Notwithstanding any other provision of this contract, if the Contractor shall elect to perform such incomplete and new work on a cost-plus-a-fixed-fee basis or agree to perform such work on some other basis, the period for which any abatement of charges is determined under the provisions of Article 6(b) and the period for which this contract has been exempted from the Renegotiation Act under the provisions of Article 29(c) shall both cease on the effective date of the notice of election or on the effective date of such mutual agreement, as the case may be, and shall not again become operative until such time, if any, as the Contracting Officer shall assign new work to the Contractor on a time and material basis under this contract.

"In the event that the Contractor, after service of such notice of election, shall again be assigned work by the Contracting Officer on a time and material basis under this contract, the billing rate for such work shall be determined by mutual agreement and, in the event no such agreement is reached, the matter shall be referred to the Contracting Officer as a disputed question of fact under Article 28 hereof."

[fol. 71] 4. The last paragraph of Article 5(d) is changed as follows:

(a) By substituting, in two places, the words and figures "one hundred-one hundred and sevenths (7/107)" for the words and figures "one hundred-one hundred and ninths (100/109)".

(b) By substituting, in two places, the words and figures "seven-one hundred and sevenths (7/107)" for the words and figures "nine-one hundred and ninths (9/109)".

5. Article 5(e) is changed as follows:

By substituting the words and figures "one hundred and seven-one hundredths (107/100)" for the words and figures "one hundred and nine-one hundredths (109/100)".

6. Article 9(c) is changed as follows:

By substituting the words and figures "one hundred-hundred and sevenths (100/107)" for the words and figures "one hundred-one hundred and ninths (100/109)".

7. Article 12(a) and 12(b) are changed as follows:

By substituting the words and figures "one hundred-one hundred and sevenths (100/107)" for the words and figures "one hundred-one hundred and ninths (100/109)".

Article II. For the current year only the repayment which may be demanded by the Contracting Officer and which shall be made by the Contractor, under the provisions of Article 6(b), shall be computed as follows:

(a) (i) the applicable provisions of Article 6(b) as existing prior to the effective date of this amending agreement shall apply to the period ending March 31, 1945;

[fol. 72] (ii) for the period beginning April 1, 1945 and ending with the end of the current year the applicable provisions shall be those of Article 6(b) as existing after the effective date of this amending agreement;

(iii) the Contractor shall submit a report for the current year within sixty (60) days after its end and the Contracting Officer may make demand for repayment with respect to such year at that time or within sixty (60) days after receipt of such report.

(b) Notwithstanding the provisions of (a) of this Article II, the period for which the aggregate costs referred to in subsections (i), (ii), and (iii) of section (b) of Article I of this amending agreement shall be the entire current year.

Article III. This amendment to the Contract shall be effective as of April 1, 1945.

Article IV. Except as herein and hereby amended, all of the terms and conditions of the Contract shall remain in full force and effect.

In witness whereof, the parties hereto have executed this agreement as of the day and year first above written.

The United States of America By [s] W. R. Gary, Contracting Officer, Bureau of Ships, Navy Department. Graham Ship Repair Co., Contractor, By [s] W. C. Graham, General Partner.

[fol. 73] Two Witnesses as to Contractor: /s/ Russell W. Small, /s/ L. C. Ebeling.

I, ..., certify that I am the .....

of the Corporation named as Contractor herein; that .....

who signed this agreement on behalf of the Contractor was then ..... of said Corporation; and that this agreement was duly signed for and in behalf of said corporation by authority of its governing body and is within the scope of its corporate power.

.....

(Corporate Seal)

(P)

EXHIBIT 2 TO PETITION

Assignment

Know all men by these presents:

That the undersigned, Graham Ship Repair Co., a Limited Partnership composed of Warren C. Graham, general partner, and Agnes B. Graham, limited partner, with its principal place of business at 501 - 1st Street, in the city of Oakland, State of California (hereinafter called "Assignor"), for and in consideration of the sum of $1.00 and other good and valuable consideration to it in hand paid, receipt of which is hereby acknowledged, has sold, transferred, assigned and set over and by these presents does sell, transfer, assign and set over unto Central Bank, a banking corporation organized and existing under and by virtue of the laws of the State of California, having its [fol. 74] principal place of business at Fourteenth Street and Broadway, Oakland, California (hereinafter called

"Bank"), its successors and assigns, any and all amounts now due or owing, or which may hereafter be or become due or owing or remain unpaid at any time or times from The United States of America, or from any Department, Agency or Commission thereof, to the Assignor under and pursuant to the terms of a certain contract dated December 30, 1944 between the United States of America, Navy Department (Bureau of Ships) and the Assignor, being Contract Number NObs-10230 including all moneys due or which may hereafter be or become due or owing or remain unpaid at any time or times for extras or changes, or under any options exercised by said Navy Department (Bureau of Ships), or under any other provisions of said contract.

The undersigned constitutes and appoints the said Bank, its successors and assigns, its true and lawful attorney, irrevocably, with full power of substitution for the undersigned and in its name to ask, require, demand and receive of the said United States of America or from any Agency, Department or Commission thereof, the said moneys herein assigned, and on non-payment thereof to sue for, recover and receive the same, and on payment thereof to give sufficient releases, receipts and discharges thereof.

This Assignment is made pursuant to the Assignment of Claims Act of 1940 and under the provisions of the aforementioned contract, and payments due under said contract and hereunder to said Bank shall not be subject to reduction or set-off for any indebtedness of the Assignor to The United States arising independently of the said contract; [fol. 75] and the undersigned specifically authorizes and directs The United States of America to make such payments as and when due under said contract to said Bank, as hereinabove provided.

And the said Assignor does hereby represent and warrant unto said Bank that the undersigned has not heretofore alienated or assigned said contract or any rights or interest therein or thereto or to the payments due or to become due thereunder.

In witness whereof the undersigned has caused this As-

signment to be duly executed and attested..... this 31st day of January, 1945.

Graham Ship Repair Co. by /s/ Warren C. Graham
General Partner.

Subscribed and sworn to before me this 31st day of January, 1945, at Oakland, California:

/s/ L. M. Guesemer Notary Public My commission expires: May 23, 1948.

EXHIBIT 3 TO PETITION

Notice of Assignment

Date January 31, 1945

To: Contracting Officer
Bureau of Ships
Navy Department
Washington, D. C.

Subject: Contract Number NObs-10230
[fol. 76] Made by the United States of America
Navy Department
Bureau of Ships

With Graham Ship Repair Co.

(Name of Contractor)

501 - 1st Street
Oakland, California

(Address of Contractor)

For the repair or alteration of vessels at Oakland, California.

Dated: December 30, 1944.

Please take notice that moneys due or to become due under the contract described above has been assigned to the undersigned pursuant to the provisions of the Assignment of Claims Act of 1940 (Public No. 811, 76th Congress), approved October 9, 1940.

A true copy of the instrument of assignment is attached hereto.

Payments due or to become due under such contract should be made to the assignee.

Please return to the undersigned the three (3) enclosed copies of this notice with appropriate notations showing the date and hour of receipt and duly signed by the person acknowledging receipt on behalf of the addressee.

Very truly yours,

Central Bank by /s/ M. M. Maze, Vice President, Fourteenth Street and Broadway, Oakland, California Zone 4

[fol. 77] Receipt is hereby acknowledged of the above notice and a copy of the abovementioned instrument of assignment. These were received at 10 A. M. on 8 February, 1945.

/s/ (Signature Illegible) on behalf of (Name Illegible), Contracting Officer, Bureau of Ships. (Name and title of Addressee of Notice).

EXHIBIT 4 TO PETITION

Notice of Assignment

Date January 31, 1945

To: Captain J. F. Kutz
Disbursing Officer
300 U. S. Appraisers Bldg
San Francisco, Calif

Subject: Contract Number NObs-10230
Made by the United States of America
Navy Department
Bureau of Ships

With Graham Ship Repair Co.

(Name of Contractor)

501 - 1st Street
Oakland, California

(Address of Contractor)

For the repair or alteration of vessels at Oakland, California.

Dated: December 30, 1944.

Please take notice that moneys due or to become due under the contract described above has been assigned to [fol. 78] the undersigned pursuant to the provisions of the Assignment of Claims Act of 1940 (Public No. 811, 76th Congress), approved October 9, 1940.

A true copy of the instrument of assignment is attached hereto.

Payments due or to become due under such contract should be made to the assignee.

Please return to the undersigned the three (3) enclosed copies of this notice with appropriate notations showing the date and hour of receipt and duly signed by the person acknowledging receipt on behalf of the addressee.

Very truly yours,

Central Bank, By /s/ M. M. Maze, Vice President, Fourteenth Street and Broadway, Oakland, California, Zone 4.

Receipt is hereby acknowledged of the above notice and a copy of the abovementioned instrument of assignment. These were received at 2:00 P. M. on 14 February, 1945.

/s/ D. J. Kierulff, Lt. Comdr. (SC) USNR on behalf of District Disbursing Officer Twelfth Naval District. (Name and title of Addressee of Notice).

[fol. 79] EXHIBIT 5 TO PETITION

Notice of Assignment

Date January 31, 1945

To: General Accounting Office
Moses Building
Washington, D. C.

Subject: Contract Number NObs-10230
Made by the United States of America
Navy Department
Bureau of Ships

With Graham Ship Repair Co.
(Name of Contractor)

501 - 1st Street
Oakland, California
(Address of Contractor)

For the repair or alteration of vessels at Oakland, California.

Dated: December 30, 1944.

Please take notice that moneys due or to become due under the contract described above has been assigned to the undersigned pursuant to the provisions of the Assignment of Claims Act of 1940 (Public No. 811, 76th Congress), approved October 9, 1940.

A true copy of the instrument of assignment is attached hereto.

Payments due or to become due under such contract should be made to the assignee.

Please return to the undersigned the three (3) enclosed copies of this notice with appropriate notations showing the date and hour of receipt and duly signed by the person [fol. 80] acknowledging receipt on behalf of the addressee.

Very truly yours,

Central Bank, By /s/ M. M. Maze, Vice President, Fourteenth Street and Broadway, Oakland, California, Zone 4.

Receipt is hereby acknowledged of the above notice and a copy of the abovementioned instrument of assignment. These were received at ..... on Feb. 5, 1945.

/s/ Florence G. Harton on behalf of for Chief Contract Service Section, General Accounting Office.

(Name and title of Addressee of Notice).

EXHIBIT 6 TO PETITION

Comptroller General of the United States
Washington 25

May 18, 1950

B-72929

Central Bank of Oakland
c/o Llewellyn A. Luce, Esquire
937 Munsey Building
Washington 4, D. C.

Gentlemen:

Reference is made to your attorney's letter of April 10, 1950, and other correspondence, relative to your claim for $110,966.08, as assignee of amounts otherwise payable to the Graham Ship Repair Company, 501 First Street, Oak- [fol. 81] land, California, under contract NObs-10230, dated December 30, 1944, for services rendered by the contractor to the Department of the Navy.

By the terms of the subject contract the contractor agreed, under a "cost reimbursable basis," to perform such alterations or repairs as specified by the Department of the

Navy and in accordance with the respective job orders issued, on any vessels delivered to contractor during the life of the contract. It appears that during the time the contract was in force numerous job orders were issued, pursuant to which the work was completed by the Graham Ship Repair Company, and payment therefor, as prescribed by the contract, was made to you in accordance with an assignment dated January 31, 1945, executed by the contractor under the assignment of Claims Act of 1940, 54 Stat. 1029.

The record indicates that during the course of performance of the contract the administrative office ascertained that the contractor had failed to remit to the Collector of Internal Revenue the sums of $453,469.55, representing withholding tax, and $11,462.91, representing Federal unemployment tax, accruing under the contract. As a result thereof no further job orders were issued in connection with the contract after March 31, 1946. Thereafter, a final adjustment was made in the accounts of the contractor and because of the conflicting claims of the assignee and the Collector of Internal Revenue, the vouchers covering the balance due under the contract were submitted to this Office for direct settlement, administratively approved in the sum of $110,966.08.

By letter of November 3, 1949, the Deputy Commissioner of Internal Revenue transmitted a copy of a report dated [fol. 82] October 21, 1949, from the Deputy Collector of the 1st California District, reading, in pertinent part, as follows:

"It is the contention of the Collector of Internal Revenue of the 1st California District that in as much as the taxes involved were incurred under this contract NOBS 10230 and did not arise independently of the contract that the tax claim takes priority over the claim of the assignee.

"This contention is further enhanced by the Navy's interpretation of the contract. The Navy holds that the master contract has no effect until job orders are secured. Further, the taxes arising during the course of the contract are considered in establishing the job rates. The contractor therefore is reimbursed on the assumption that his taxes

are paid. The taxes therefore are definitely part of the costs of the contract. If that is true no valid assignment can be made until all the costs of the contract are met.

"The contractor (Graham Ship Repair Co.) when challenged by the Navy Department as to the payment of taxes, presented a check punched and cancelled by the Collector of Internal Revenue in the amount of $350,000.00. The contractor stated to the Navy Department that this check was his receipt for payment of taxes then due the Collector of Internal Revenue. This check was never presented to the Collector of Internal Revenue in payment of taxes due. It did however represent considerable effort on the part of the contractor to deceive the Navy Department and had the effect of continuing the job orders from the Navy. Shortly thereafter, the Navy Department made an audit of the books of the Graham Ship Repair Co. and discovered the fraud. No further job orders were forthcoming since the audit."

[fol. 83] The Assignment of Claims Act of 1940, supra, provides, insofar as pertinent to this case, that—

"Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract."

The instant contract, under article 15(o), contains a provision to that effect pursuant to which the referred-to assignment was executed. While several contentions have been made by your attorneys in prior correspondence as to the merits of your claim, it was informally understood from a recent conference between them and representatives of this Office that the only basis upon which the claim now warrants consideration by this Office is the contention that the indebtedness of the contractor to the United States for the unpaid taxes arose independently of the contract and therefore that the claimed amount due may "not be subject to reduction or set-off" within the meaning of the involved

act. In that connection, it is contended in your brief dated January 2, 1948, that the indebtedness of the assignee-contractor arose under the revenue statutes and completely independent of the contract obligations with the result that the amount due may not be applied to the debts of the contractor due the United States. Also, in your attorney's brief of April 10, 1950, it is contended that the principal objective of the act was to provide absolute security to lending institutions which advanced money for national [fol. 84] defense purposes on the strength of an assignment of claims under Government contracts, and, therefore, that the Government would have no right to withhold from an assignee money due under an assigned contract merely because the contractor was indebted to the Government because of unpaid taxes.

At the outset, it may be noted that the Assignment of Claims Act of 1940, as originally proposed and as recommended by the Congressional committees which considered it, did not contain the provision here in question which prohibits set-offs by the Government in certain cases. That provision was proposed as an amendment on the floor of the Senate, and the purpose of the bill prior to the addition of such provision was merely to remove the restrictions in sections 3477 and 3737 of the Revised Statutes against the assignment of claims against the United States. As was stated by Senator Barkley in the hearings before the Senate Committee on Banking and Currency:

"* * * The main purpose is to permit contractors who may not have enough working capital—and this particularly affects small contractors—to go ahead with Government contracts; so that if they have to go to the bank and borrow money, they can assign the contract as security and they can get the money and can go ahead with the work; then when the work is completed and the Government is ready to pay the contractor, naturally the bank has a first claim on it."

No question appears to have arisen in the hearings, or at any time prior to the amendment of the bill, as to the right of the Government to withhold from the assignee

amounts due under a contract in order to liquidate any indebtedness of the assignor to the United States. The effect of the amendment, as stated by Senator Barkley in [fol. 85] proposing it, was to prohibit offsetting against a contract an indebtedness which the contractor might owe the Government "on account of some other contract or some other situation." And in response to an inquiry whether the amendment would not permit an unscrupulous contractor who owed the Government money to evade his liability, Senator Barkley stated that was possible, but that the Government would be in no worse position in collecting such a debt by reason of the proposed amendment, presumably because without the amendment the contractor could not undertake the contract, since a bank would not lend money on such a contract if the Government could come in and assert a claim against the contractor "on account of something else which had no relationship whatever to the contract and the defense program." It seems clear from the foregoing that it did not occur to the proponents of the provision here involved that it would prevent the setoff of debts to the Government which might arise by virtue of performance of the very contract which was assigned. Indeed, the words used in the statute, "arising independently of such contract," would appear to indicate an intent to exclude only those debts which were unrelated to the assigned contract.

In the letter of January 2, 1948, submitted by your attorneys, the contention is made that because the contractor's obligations as to withholding taxes and the Government's rights in enforcing such obligations are determinable solely by reference to the tax statutes, any such obligations and indebtedness deriving therefrom must arise independently of the contract involved. This contention appears to overlook the fact that no obligations under the pertinent tax [fol. 86] statutes can arise until wages are paid, and the specific obligations here involved did not arise until wages were paid for the performance of service under the instant contract. Thus, the present indebtedness owes its very existence to the performance of work under the assigned contract, and but for that contract such debt would never have arisen.

Obviously, it was known to the contractor when he executed the contract, and to you when you obtained the assignment thereunder, that wages would have to be paid for labor to perform the contract. Both you and the contractor knew that a part of those wages was required by law to be paid to the Collector of Internal Revenue, and that until such part of the wages was so paid the amount thereof would be owed by the contractor to the Government. It must have been apparent, also, that the stipulated contract compensation for direct labor hours was fixed in consideration of the payment of the contractor of the taxes involved. In other words, the contract could not be performed unless the very debt now in question arose. It seems more than clear that any indebtedness which necessarily and inescapably must be incurred in the performance of a contract cannot reasonably be said to arise "independently" of such contract.

For the foregoing reasons, it is the considered opinion of this Office that the indebtedness under consideration did not arise independently of contract No. NObs-10230 within the meaning of the Assignment of Claims Act of 1940, supra. Accordingly, since your right to payment of the funds is subject to all the equities available to the Government against the assignor so far as concerns the right of setoff for obligations of the assignor to the Government [fols. 87-88] arising out of the contract (*United States* v. *Munsey Trust Co.*, 332 U. S. 234; *Modern Industrial Bank* v. *United States*, 101 C. Cls. 808, 820), the amount otherwise found to be due under the final payment voucher will be withheld and applied to partial liquidation of the contractor's indebtedness to the United States. Therefore, your claim must be, and is, disallowed.

Very truly yours,

/s/ Lindsay Warren, Comptroller General of the United States

[fols. 89-90] GENERAL TRAVERSE—

Filed November 1, 1950.

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

/s/ H. G. Morison, Assistant Attorney General.

REM

SRG

[fol. 91] IN THE UNITED STATES COURT OF CLAIMS

No. 49825

Central Bank, a corporation, Plaintiff,

v.

United States of America, Defendant.

STIPULATION OF FACTS—Filed Sept. 26, 1951

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel of record, that the following facts are true and may be included by the Court in its Special Findings of Fact, subject to the right of the parties to introduce other or further evidence not inconsistent with the facts herein stipulated.

I

The plaintiff is a corporation duly organized under and by virtue of the laws of the State of California, with a principal office and place of business in the City of Oakland, State of California. Throughout the years involved in this suit and up to the present date, the plaintiff was and is engaged in the banking business.

[fol. 92] II

On December 30, 1944, Graham Ship Repair Company, Oakland, California, entered into a contract with the Navy

Department of the United States for ship repair work. Said contract is known and identified as NObs-10239 and a copy of said contract is attached hereto as Exhibit 1 and by reference made a part hereof.

III

Said Graham Ship Repair Company was a partnership engaged in business at 501 First Street, Oakland, California, organized and existing under the laws of the State of California.

IV

On April 1, 1945, the contract entered into on December 30, 1944, by the Graham Ship Repair Company, Oakland, California, and the Navy Department of the United States, was amended by agreement between the parties. A copy of the agreement amending such contract is attached hereto as Exhibit 2 and by reference made a part hereof.

V

After the execution of said contract with the Navy Department of the United States, the Graham Ship Repair Company arranged with the plaintiff, Central Bank, Oakland, California, for the financing of the work under the contract and as security for the funds to be advanced the Graham Ship Repair Company on January 31, 1945, assigned the proceeds payable under the contract to the plaintiff bank. This assignment was made pursuant to the pro-
[fol. 93] visions of the Assignment of Claims Act of 1940, 54 Stat. 1029. A copy of the assignment is attached hereto as Exhibit 3 and by reference made a part hereof.

VI

The Contracting Officer, Bureau of Ships, Navy Department, the Disbursing Officer and the General Accounting Office were duly notified of the aforesaid assignment as required by the provisions of the Assignment of Claims Act of 1940. Copies of the notice of assignment, to which were attached copies of the assignment, are attached hereto as Exhibits 4, 5 and 6 and by reference made a part hereof.

VII

After the execution of the assignment the plaintiff did advance and loan to said Graham Ship Repair Company, the contractor, substantial sums of money to pay for labor and material costs in connection with the work of said Graham Ship Repair Company under its Navy Department Contract NObs-10230, and the amendment thereto. During the course of performance of the contract the appropriate administrative officers of the Government ascertained that the contractor had failed to pay over and remit to the Collector of Internal Revenue the sums of $453,469.55, withholding tax, and $11,462.91, federal unemployment tax. These amounts represented withholdings by the contractor from salaries and wages of employees or laborers of the contractor engaged in the performance of Navy Contract NObs-10230, dated December 30, 1944, which the contractor as an employer was required to withhold by the provisions of Sections 1401 and 1622 of the Internal Revenue Code, [fol. 94] and which the partners of the Graham Ship Repair Company, the contractor, had converted to their own use. Because of this failure of the contractor no further job orders were issued to it under Contract NObs-10230 after March 31, 1946. The partners in Graham Ship Repair Company, the contractor, were indicted in the United States District Court for the Northern District of California, Southern Division, under Section 2707(c) of the Internal Revenue Code (26 U.S.C., Sec. 2707(c)), for willful attempt to evade and defeat the payment of the aforesaid withheld taxes, and they pleaded guilty to the charge.

VIII

At the time the aforesaid contract was terminated the Graham Ship Repair Company was indebted to the Government for the unpaid withholding taxes, referred to in Paragraph VII above, which with interest and penalty aggregated $616,750.95. At that time there was due the contractor for work performed under Navy Contract NObs-10230 the sum of $110,966.08.

At that time the contractor was indebted to the plaintiff bank for an amount in excess of $110,966.08 for advances

made for labor and material costs in connection with that work, which amount is still outstanding and unpaid.

IX

By reason of the outstanding taxes due from the Graham Ship Repair Company referred to in Paragraph VIII, the Commissioner of Internal Revenue asserted a claim against the Navy Department for the balance due under the contract, namely, $110,966.08. The plaintiff also claimed payment of that amount under the assignment of the contractor [fols. 95-96] (Exhibit 3) and because of the conflicting claims the matter was referred by the Navy Department to the General Accounting Office for direct settlement.

X

By decision dated May 18, 1950, addressed to plaintiff, the Comptroller General of the United States ruled that the sum of $110,966.08 due the Graham Ship Repair Company was a proper setoff against the taxes due from the contractor referred to in Paragraph VIII and denied plaintiff's claim. A copy of that ruling is attached hereto as Exhibit 7 and by reference made a part hereof. Thereafter, by the issuance of appropriate Certificates of Settlement, the Comptroller General effected the aforesaid setoff, thereby reducing the tax indebtedness of the Graham Ship Repair Company to $415,018.17, which for purposes of this case plaintiff admits is still outstanding and unsatisfied.

XI

In December, 1946, the Commissioner of Internal Revenue duly made appropriate assessments of the taxes due from the Graham Ship Repair Company and thereafter and in December, 1946, the Collector of Internal Revenue at San Francisco, California, duly filed liens against that taxpayer for such taxes. Such liens were duly recorded.

/s/ Llewellyn A. Luce, Attorney for Plaintiff.

/s/ Theron L. Caudle, J.H.S., Assistant Attorney General.

[fols. 97-98] ARGUMENT AND SUBMISSION OF CASE

On April 7, 1952, the case was argued and submitted on merits by Messrs. George H. Koster and Llewellyn A. Luce for plaintiff, and by Mr. Joseph H. Sheppard for defendant.

[fol. 99] **Special Findings of Fact, Conclusion of Law and Opinion of the Court by Littleton, J.—Filfed July 15, 1952.**

Messrs. Llewellyn A. Luce and George H. Koster for the plaintiff.

Mr. Joseph H. Sheppard, with whom was Acting Assistant Attorney General Mr. Ellis N. Slack, for the defendant. Mr. Andrew D. Sharpe was on the brief.

The plaintiff, assignee of the Graham Ship Repair Company, a partnership of Oakland, California, seeks to recover $110,966.08 representing the final balance due under a contract between the Graham Company and the Navy Department. The Government refused to pay said amount to plaintiff, the assignee of the contractor, but set off said amount in partial satisfaction of $464,932.46 taxes due from the contractor, the Graham Ship Repair Company. These taxes represented amounts withheld from salaries and wages of employees and laborers engaged in the performance of the Navy contract above mentioned.

The plaintiff contends that this set-off by the Government against the amount due it by the contractor was improper under the provisions of the Assignment of Claims Act of 1940 (54 Stat. 1029), because the claim of the Government against the contractor arose independently of the contract between Graham Company and the Government. The defendant insists that the offset was proper and legal because the withholding and social security taxes, which the contractor failed to pay to the Collector of Internal Revenue, [fol. 100] arose in connection with and were directly related to the contract between the Navy and the Graham Company.

The court, upon the facts as stipulated by the parties, and the briefs and argument of counsel, makes the following

Special Findings of Facts

1. The plaintiff is a California corporation with its principal office and place of business in the City of Oakland. Throughout the years involved in this suit and up to the present date, the plaintiff was and is engaged in the banking business.

2. On December 30, 1944, Graham Ship Repair Company, a partnership, Oakland, California, entered into a contract NObs-10230 with the Navy Department of the United States for ship repair work.

3. After the execution of said contract the Graham Ship Repair Company arranged with the plaintiff, Central Bank, Oakland, California, for the financing of the work under the contract and as security for the funds to be advanced the Graham Ship Repair Company on January 31, 1945, assigned the proceeds payable under the contract to the plaintiff bank. This assignment was made pursuant to the provisions of the Assignment of Claims Act of 1940, 54 Stat. 1029.

4. The Contracting Officer, Bureau of Ships, Navy Department, the Disbursing Officer and the General Accounting Office were duly notified of the assignment as required by the provisions of the Assignment of Claims Act of 1940.

5. After the execution of the assignment the plaintiff did advance and loan to Graham Company, the contractor, substantial sums of money to pay for labor and material costs in connection with the work of said Graham Company under its contract and the amendment thereto. During the course of performance of the contract the appropriate administrative officers of the Government ascertained that the contractor had failed to pay over and remit to the Collector of Internal Revenue the sums of $453,469.55, withholding tax, and $11,462.91, Federal unemployment tax. These amounts represented withholdings by the contractor from salaries and wages of employees or laborers of the contractor engaged in the performance of Navy Contract NObs-10230, [fol. 101] which the contractor as an employer was required to withhold by the provisions of Sections 1401 and 1622 of the Internal Revenue Code, and which the partners of the Graham Company, the contractor, had converted to their

own use. Because of this failure of the contractor no further job orders were issued to it under the contract after March 31, 1946. The partners in Graham Company, the contractor, were indicted in the United States District Court for the Northern District of California, Southern Division, under Section 2707 (c) of the Internal Revenue Code (26 U. S. C., Sec. 2707 (c)), for willful attempt to evade and defeat the payment of the aforesaid withheld taxes, and they pleaded guilty to the charge.

6. At the time the contract was terminated the Graham Company was indebted to the Government for the unpaid withholding taxes, referred to in finding 5, which with interest and penalty aggregated $616,750.95. At that time there was due the contractor for work performed under the contract the sum of $110,966.08.

At that time the contractor, was also indebted to the plaintiff for an amount in excess of $110,966.08, for advances made for labor and material costs in connection with that work, which amount is still outstanding and unpaid.

7. By reason of the above-mentioned outstanding taxes due from the Graham Company, the Commissioner of Internal Revenue asserted a claim against the Navy Department for the balance due under the contract, namely, $110,966.08. The plaintiff also claimed payment of that amount under the assignment of the contractor and because of the conflicting claims the matter was referred by the Navy Department to the General Accounting Office for direct settlement.

8. By decision dated May 18, 1950, addressed to plaintiff, the Comptroller General of the United States ruled that the sum of $110,966.08 due the Graham Ship Repair Company was a proper set-off against the taxes due from the contractor, and denied plaintiff's claim. Thereafter, by the issuance of appropriate Certificates of Settlement, the Comptroller General effected the aforesaid set-off thereby reducing the tax indebtedness of the Graham Ship Repair Company to $415,018.17, which for purposes of this case plaintiff admits is still outstanding and unsatisfied.

9. In December 1946, the Commissioner of Internal Revenue made appropriate assessments of the taxes due from [fol. 102] the Graham Ship Repair Company, and thereafter in December 1946, the Collector of Internal Revenue at

San Francisco, California, filed liens against that taxpayer for such taxes. Such liens were duly recorded.

Conclusion of Law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court concludes, as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be entered by the clerk and collected by him according to law.

Opinion

Littleton, Judge, delivered the opinion of the court:

On December 30, 1944, the Graham Ship Repair Company, a partnership of Oakland, California, hereinafter referred to as the Graham Company, entered into a contract with the Navy Department for certain ship repair work. After the execution of the contract, the Graham Company arranged with plaintiff, a banking institution, for the financing of the work under contract and as security for funds to be advanced, the Graham Company, on January 31, 1945, assigned to plaintiff the proceeds payable to it under the contract, such assignment being made pursuant to the provisions of the Assignment of Claims Act of 1940 (54 Stat. 1029). Pursuant to such assignment plaintiff advanced to the Graham Company substantial sums of money for use in the performance of the contract. During the course of performance of the contract the Government ascertained that the Graham Company had failed to pay over and remit to the Collector of Internal Revenue the sums of $453,469.55, withholding tax, and $11,462.91, Federal unemployment tax, aggregating $464,932.46. These taxes represented amounts withheld from salaries and wages of employees or laborers of the contractor who were engaged in the performance of the Navy Contract, above referred to. The amounts so withheld had been converted by the partners of the Graham Com-
[fol. 103] pany to their own use. The Graham Company as an employer, was required to withhold and pay over these taxes to the Collector by the provisions of Sections 1401 and 1622 of the Internal Revenue Code. Because of the failure of

the contractor to pay such taxes to the Collector, the Navy Department declined to issue further job orders to the Graham Company and terminated the contract. The interest and penalties on the taxes which the Graham Company failed to pay, as required by law, amounted to $151,818.49, making a total of $616,750.95 due from the Graham Company on account of such taxes. The partners of the Graham Company were indicted for willful attempt to defeat and evade the payment of the withheld taxes and they pleaded guilty.

At the time the Navy contract with the Graham Company was terminated there was due to the Graham Company, for work performed under the contract, the sum of $110,966.08. At that time, also, the Graham Company was indebted to the plaintiff for an amount in excess of $110,966.08 for advances made by plaintiff in connection with the performance of the contract.

The taxes, interest, and penalties, due from the Graham Company were duly assessed by the Commissioner of Internal Revenue. Plaintiff made claim for the balance due under the contract but the Government refused to pay said sum to it, and by a final settlement certificate issued by the General Accounting Office, May 18, 1950, the sum of $110,966.08 due the Graham Company was offset in partial satisfaction of the indebtedness of the Graham Company to the United States. After this offset, there remained due from the Graham Company $415,018.17 which is still outstanding and unpaid.

The United States had the right to set off the amount here in question due from it to the Graham Company under the contract of December 30, 1944, *United States* v. *Munsey Trust Co.*, 332 U. S. 234; *Modern Industrial Bank* v. *United States*, 101 C. Cls. 808; *Seaboard Surety Company* v. *United States*, 107 C. Cls. 34; *Royal Indemnity Co.* v. *United States*, 117 C. Cls. 736. But the plaintiff contends that under the facts in this case such offset was improper and was prohibited by the provisions of the Assignment of Claims Act of 1940 (54 Stat. 1039), inasmuch as the indebtedness of the [fol. 104] Graham Company to the government for the taxes in question arose independently of the contract of December 30, 1944, between the Graham Company and the

Navy Department. The Assignment of Claims Act, so far as here material, provided as follows:

> Any contract entered into by the War Department or the Navy Department may provide that payments to any assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

We are of the opinion that the indebtedness of the assignor, the Graham Company, to the United States for the taxes in question was not so independent of the contract of December 30, 1944, as to preclude the Government from offsetting the balance due under the contract against such indebtedness. As hereinbefore stated, the tax indebtedness of the Graham Company arose by reason of and in connection with its performance of work under this contract. The assignee knew that the contractor would be required to withhold and pay taxes to the defendant. The obligation of the contractor for the taxes in question arose before the partners converted such taxes to their own use and such obligation was therefore directly associated with the contract. The tax obligation in question also had a direct relation to the contract. Section 1622a of the Internal Revenue Code, 26 U. S. C., 1622a, provides:

> Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 15 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b) (1).

Section 1623 of the Internal Revenue Code provides that "The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment."

We do not find anything in the history of the Assignment of Claims Act which requires the conclusion that Congress

[fols. 105-106] intended to take away from the Government the right, in a case such as this, to offset a balance due from it to an assignor against an indebtedness of the character here involved of such assignor. It is true that the indebtedness of the Graham Company for the taxes in question was not entirely dependent upon the contract; but we think it is clear that such indebtedness was not entirely independent of such contract. In order to be independent, as we think that term was used and intended by the Assignment of Claims Act, the indebtedness must arise irrespective of, exclusive of, and separate from the contract, and must have no direct relation with such contract. We think Congress intended that the above quoted provision of the Assignment of Claims Act should be interpreted and applied in accordance with the ordinary and natural meaning of the language used.

The defendant was not a mere stakeholder but was the owner of the fund amounting to $110,966.08 to be disbursed, and was also the owner of a claim against said fund. As a general proposition of law, the Government was in a better position than plaintiff as a claimant to a fund representing the balance due under the contract. In *United States* v. *Munsey Trust Co.*, 332 U. S. 234, 240, the Court said:

> * * * And one whose own appropriation and payment of money is necessary to create a fund for general creditors is not a general creditor. He is not compelled to lessen his own chance of recovering what is due him by setting up a fund undiminished by his claim, so that others may share it with him. In fact, he is the best secured of creditors; his security is his own justified refusal to pay what he owes until he is paid what is due him.

From a careful consideration of the right of the Government, generally, to offset amounts due from it to a contractor against amounts due from such contractor, in the light of the facts in this case and the above quoted provision of the Assignment of Claims Act of 1940, we are of the opinion that the offset made by the defendant in this case was proper and that plaintiff is not entitled to recover. The petition is, therefore, dismissed. It is so ordered.

Howell, Judge; Madden, Judge; Whitaker, Judge; and Jones, Chief Judge, concur.

[fols. 107-108] JUDGMENT OF THE COURT—July 15, 1952

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover.

It is therefore adjudged and ordered that the plaintiff's petition be and the same is hereby dismissed.

[fols. 109-110] PROCEEDINGS AFTER ENTRY OF JUDGMENT

On August 13, 1952, the plaintiff filed a motion for a new trial.

On October 7, 1952, the court entered the following order on said motion:

ORDER

These cases come before the Court on motion for a new trial; and, on consideration thereof,

It is ordered this seventh day of October, 1952, that said motions be and the same are overruled as follows:

* * * * * * *

49825 Central Bank, a Corporation. Plaintiff's motion.

* * * * * * *

By the Court, /s/ Marvin Jones, Chief Judge.

[fol. 111] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 112] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1952

No. 521

CENTRAL BANK, a Corporation, Petitioner,

vs.

THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 9, 1953

The petition herein for a writ of certiorari to the United States Court of Claims is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

LIBRARY
SUPREME COURT, U.S.

DEC 26 1952

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 521

CENTRAL BANK, A CORPORATION,
Petitioner,

vs.

THE UNITED STATES

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

LLEWELLYN A. LUCE,
GEORGE H. KOSTER,
Counsel for Petitioner.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 521

CENTRAL BANK, A CORPORATION,

Petitioner,

vs.

THE UNITED STATES

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

Petition

The petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Claims entered on July 15, 1952 (R. 79), based on an opinion of the Court of Claims (R. 75-78); said judgment of the Court of Claims became a final judgment of that Court on October 7, 1952, when the Court of Claims denied the motion of the plaintiff for a new trial (R. 79).

Statement

The essential facts are not in dispute; they are briefly as follows:

The petitioner is a California Banking Corporation, engaged in the banking business at all of the times involved in this suit (R. 68).

On December 30, 1944, Graham Ship Repair Company, a partnership, entered into a contract, NOBs—10230, with the Navy Department of the United States for ship repair work (R. 10-56; 69); Article 15 (b & c) of this contract authorized Graham Ship Repair Co. to assign monies due or to become due to it, under said contract, to any bank, as security (R. 34-35).

Graham Ship Repair Co. arranged with petitioner that petitioner should advance funds to it, to enable Graham Ship Repair Co. to carry out said ship repair contract; on January 31, 1945, Graham Ship Repair Co. assigned all monies due or to become due to it, under said contract, to petitioner, as security for funds so advanced and to be advanced by petitioner (R. 56-58; 69). This assignment was made under and pursuant to the provisions of the Assignment of Claims Act of 1940, 54 Stat. 1029 (R. 58; 69).

After the execution of said assignment, petitioner did loan substantial sums of money to Graham Ship Repair Co. to pay for labor and material costs of ship repairs performed by Graham Ship Repair Co. under said Navy contract NOBs-10230 (R. 70).

Graham Ship Repair Co. withheld $453,469.55 withholding tax and $11,462.91 Federal Unemployment Tax, from the salaries and wages of its employees engaged in the ship repair work under said Navy contract NOBs-10230; these amounts were withheld by Graham Ship Repair Co. under the requirements of Sections 1401 and 1622 of the Internal Revenue Code. Graham Ship Repair Co. failed to pay over to the Collector of Internal Revenue said sums withheld, and converted the same to its own use (R. 70). Because of this, no further ship repair job orders were given to Graham Ship Repair Co., after March 31, 1946; the partners of Graham Ship Repair Co. were indicted and convicted of

wilful attempt to evade payment of said withheld tax monies (R. 70).

At termination of said contract, there was due, for work performed under it, the sum of $110,966.08; at that time, also, Graham Ship Repair Co. was indebted to petitioner for amounts in excess of $110,966.08, for monies advanced by petitioner to Graham Ship Repair Co. to pay for labor and material costs of said ship repair contract (R. 70).

At termination of said contract, Graham Ship Repair Co. was indebted to the United States for the withheld tax monies it had converted, plus penalties and interest as to same, in the total sum of $616,750.95 (R. 70).

Petitioner claimed the amount due under said Navy contract, $110,966.08, under the assignment to it by Graham Ship Repair Co. The Commissioner of Internal Revenue also claimed said balance of $110,966.08, to apply upon the aforesaid tax liabilities of Graham Ship Repair Co. (R. 71).

The Comptroller General of the United States ruled that said tax claims of the United States, against Graham Ship Repair Co., could be set-off against the amount of $110,966.08, due and owing under said Navy contract NOBs-10230, and administratively effected said set-off (R. 71).

In December, 1946, the Commissioner of Internal Revenue duly assessed against Graham Ship Repair Co. the amounts due from it as to withheld but unpaid tax monies, and duly filed and recorded liens against Graham Ship Repair Co. for such tax monies (R. 71).

Questions Presented

1. As the assignment to Central Bank gave Central Bank a valid security title to the contract proceeds, under the Assignment of Claims Act of 1940 and the provisions of the contract, is it not true that Central Bank is protected against set-off by the United States of the liabilities of the

contractor subsequently arising out of the criminal embezzlements and fraud of the contractor?

2. Is it not true that the attempt to set-off by the United States, contrary to accepted principles of law as to set-off and in violation of the spirit and meaning of the Assignment of Claims Act of 1940, constitutes such an apparent breach of business integrity by the United States as to seriously affect the future position of the United States when it attempts to procure private financing for defense and survival?

Reasons for Granting the Writ

The sanction by the Court of Claims of the set-off asserted by the United States is in clear violation of the principles of law applicable and of the spirit and meaning of the Assignment of Claims Act of 1940.

This case involves a vitally important federal question. The United States passed the Assignment of Claims Act of 1940 in order to have private banks lend money, with assurance, upon the security of assignments of the proceeds of war contracts. The petitioner bank did loan money to Graham Ship Repair Co., on a Navy contract, in reliance upon said Act. Thus, the United States obtained the financing that it desired. Subsequently, Graham Ship Repair Co. practiced gross criminal fraud on the United States, embezzling withheld tax monies. The petitioner bank had nothing whatever to do with such acts. The United States then sought to defeat the security rights of the petitioner bank, in the assigned contract proceeds, by setting off against such proceeds the subsequently arising liabilities of the contractor. Such reversal of position by the United States, to the prejudice of an innocent purchaser for value of the contract proceeds, impugns the business integrity of the United States. The importance of this case lies in the fact that the proceedings involved place the United States

in a position where private business concerns may well view the business integrity of the United States with a certain suspicion and doubt. The placing of the United States in such a position should never be permitted. The business integrity and fair dealing of the United States is a precious asset, to be guarded with vigilance. The preservation of that asset cries out for review of this judgment, and the reversal of the same.

Conclusion

WHEREFORE, it is submitted that the Writ of Certiorari should be granted.

Respectfully submitted,

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BRIEF IN SUPPORT OF PETITION

Opinion Below

The opinion of the Court of Claims (R. 75-79) is reported in 105 Fed. Supp. 992.

Jurisdiction

The judgment of the Court of Claims was entered July 15, 1952 (R. 79). Central Bank moved for a new trial August 13, 1952; on October 7, 1952, the Court of Claims denied said motion (R. 79). The judgment of the Court of Claims did *not* become final, so that certiorari could be sought as to the same, until October 7, 1952, when the Court of Claims denied petitioner's motion for a new trial. United States vs. Ellicott, 223 U. S. 524, 32 S. Ct. 334 (1912); Chicago R. Co. vs. United States, 54 Court of Claims 116; United States vs. Cresent Amusement Co., 323 U. S. 173, 65 S. Ct. 254 (1944).

Jurisdiction is conferred on this court by Section 1255, Title 28, United States Code (62 Stat. 928).

Statement

The essential facts are stated in the preceding petition (pages 1-3).

Question Presented

The question presented is stated in the preceding petition (page 3).

Specification of Error to Be Urged

The error is that the right of the petitioner to its security for money loaned, in assigned contract proceeds, as against subsequently arising claims of the United States against the contractor for criminal embezzlement of withheld tax monies, is completely clear, and that the denial of such

security by the court below is patently erroneous. Such denial not only adversely affects petitioner's property right, but also has an important adverse effect upon the United States itself, as casting doubt upon the business integrity of the United States in the field of business and finance.

ARGUMENT

Certiorari Should Be Granted

THE UNITED STATES INDUCED THE LOANING OF MONEY BY PETITIONER TO THE CONTRACTOR, BY PASSAGE OF THE ASSIGNMENT OF CLAIMS ACT OF 1940; THE RIGHT OF THE PETITIONER TO BE PROTECTED IN ITS SECURITY, TAKEN PURSUANT TO SAID ACT, AS AGAINST THE SUBSEQUENTLY ARISING CLAIMS OF THE UNITED STATES AGAINST THE CONTRACTOR FOR CRIMINAL EMBEZZLEMENT OF WITHHELD TAX MONIES, IS SO CLEAR THAT THE RULINGS TO THE CONTRARY BY THE COMPTROLLER GENERAL OF THE UNITED STATES AND BY THE COURT BELOW HAVE THE EFFECT OF IMPUGNING THE BUSINESS INTEGRITY OF THE UNITED STATES IN THE BUSINESS AND FINANCIAL WORLD. THESE ERRONEOUS RULINGS ADVERSELY AFFECT THE UNITED STATES IN THE VITAL FIELD OF GETTING PRIVATE FINANCING FOR DEFENSE AND FOR SURVIVAL. THE QUESTIONS PRESENTED ARE VITALLY IMPORTANT, AS IT IS ESSENTIAL TO THE UNITED STATES TO AVOID THE APPEARANCE OF HAVING A LACK OF BUSINESS INTEGRITY IN ITS BUSINESS DEALINGS TO PROCURE PRIVATE FINANCING.

Prior to the passage of the Assignment of Claims Act of 1940, two Federal statutes prohibited the assignment of contracts with the United States, or interests therein (41 U. S. Code, Section 15; 31 U. S. Code, Section 203).

Said two statutes were amended by the Assignment of Claims Act of 1940 (54 Stat. 1029). Said amendment permitted assignment of such contracts to a bank or financing institution, and further provided as follows:

> "Any contract entered into by the War Department or the Navy Department may provide that payments to any assignee of any claim arising under such con-

tract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract."

Speaking of the no set-off provision above quoted, while it was being debated by the United States Senate, Senator Barkley explained such amendment, as follows (Congressional Record, 76th Congress, Page 12803):

"Mr. President, the amendment merely provides that when a contractor, in order to obtain money so that he may perform his contract with the Government under the defense program, assigns his contract to a bank or trust company in order to get money with which to proceed with the work, it shall not be permissible to offset against the claim or contract later an indebtedness which the contractor may owe the Government on account of some other contract or *some other situation.*" (Emphasis added.)

Hearings were held on the Assignment of Claims Act of 1940, before the Senate Committee on Banking and Currency. In the hearing held September 14, 1940, 76th Congress, 3rd Session, Senator Barkley spoke in part as follows (Report of Hearings, page 2):

"The object of this proposed legislation is to remove the restrictions on these two Sections referred to regarding the assignment of contracts with the Government. The main purpose is to permit contractors who may not have enough working capital—and this particularly affects small contractors—to go ahead with Government contracts; so that if they have to go to the bank and borrow money, they can assign the contract as security and then can get the money and can go ahead with the work; then when the work is completed and the Government is ready to pay the contractor, naturally the bank has a *first* claim on it." (Emphasis added.)

The petitioner took an assignment of the Navy contract between Graham Ship Repair Co. and the United States, on January 31, 1945, and loaned Graham Ship Repair Co. the monies that enabled it to carry out the ship repair contract.

Such Navy contract (R. 10-56) is completely silent as to any obligations on the part of Graham Ship Repair Co. to withhold taxes from its employees, and pay the same over to the United States.

Sections 1401 and 1622 of the Internal Revenue Code did impose such obligations on Graham Ship Repair Co., and Graham Ship Repair Co. did in fact make such withholdings.

In this situation, the Federal statute delineating the right and duty of Graham Ship Repair Co., was Section 3661 of the Internal Revenue Code, which read as follows:

> "Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States."

The petitioner submits that the obligation of Graham Ship Repair Co. was not a contract indebtedness, but that Graham Ship Repair Co., as to tax monies it withheld, acted as a trustee for the United States, and held such monies, as trustee, under Section 3661 of the Internal Revenue Code, above set forth. Apart from such trust fund so held, Graham Ship Repair Co. was not indebted to the United States, as to such tax monies. General indebtedness of Graham Ship Repair Co. to the United States, as to such monies, only arose when Graham Ship Repair Co. criminally embezzled the trust res. Such criminal embezzlement was something that had no relation to the contract, and could not possibly have been foreseen or guarded against.

It is true that where an employer does not withhold at all, he becomes generally indebted for the amounts he should

have withheld, under Section 1623 of the Internal Revenue Code. This is not the situation in the case at bar, as here the employer did in fact withhold. Having done this, the trust provision of Section 3661 of the Internal Revenue Code immediately was applicable. At this point, Graham Ship Repair Co. was not "indebted" to the United States, but simply was a trustee, owing the duty to turn over the trust res to the United States. This is shown by the consideration that, with such trust fund intact, the United States would have no cause of action at all for a general indebtedness; rather, its sole remedy would be in equity, to compel the trustee to turn over to it the trust res. Subsequently, when Graham Ship Repair Co. embezzeled the trust res, it then became generally liable to the United States for the amount of the embezzlement. These considerations show that the claim of the United States only arises from the subsequent independent criminal act of embezzlement by Graham Ship Repair Co.

The Court of Claims completely lost sight of the nature of the obligation of Graham Ship Repair Co., which was for criminal embezzlement of trust funds. Thus, the opinion of the Court of Claims erroneously states (R. 77) "The obligation of the contractor for the taxes in question arose before the partners converted such taxes to their own use * * *". This erroneous assumption by the Court of Claims directly underlay and conditioned the erroneous judgment entered herein by the Court of Claims.

When the United States passed the Assignment of Claims Act of 1940, in order to get private financing for contractors working on war contracts, the United States acted in its business capacity, to effect commercial transactions; this means that the United States should be held bound by the same rules of law that govern individuals in such transactions.

In *United States* v. *Seaboard Air Line Ry. Co.*, 22 Fed. 2d 113 (1927), the Circuit Court of Appeals for the Fourth Circuit, in holding that the United States was fully subject to the general rules of commercial law, as to a Bill of Lading to which it was a party, spoke in part as follows (Page 115):

> "And the rule is well settled that, when the 'government * * * comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there.' Cooke vs. U. S., 91 U. S. 389, 398, 23 L. Ed. 237; Standard Oil Co. v. U. S., 267 U. S. 76, 45 S. Ct. 211, 69 L. Ed. 519; Chesapeake & Delaware Canal Co. v. U. S., 250 U. S. 123, 126, 39 S. Ct. 407, 63 L. Ed. 889; U. S. v. Bank of Metropolis, 15 Pet. 377, 392, 393, 10 L. Ed. 774; U. S. v. Barker, 12 Wheat. 559, 6 L. Ed. 728; England Nat. Bank v. U. S. (C. C. A. 8th) 282 F. 121."

Accord: United States v. *National Exchange Bank*, 270 U. S. 527, 46 S. Ct. 388 (1926, where Mr. Justice Holmes spoke in part as follows (Page 389):

> "The United States does business on business terms. Cooke v. United States, 91 U. S. 389; 23 L. Ed. 237."

57 Corpus Juris, on *Set-Off and Counterclaim*, Section 95, pages 444-445, states the applicable law as follows:

> "* * *, it is a broad general rule of practically universal application that to warrant a set-off the demands must be mutual and subsisting between the same parties, and furthermore must be due in the same capacity or right, and there must be mutuality as to the quality of the right."

The tax monies withheld by Graham Ship Repair Co. being held in trust for the United States, the claim of the United States is really a claim as the beneficiary of a trust, arising out of the criminal embezzlement of the trust res by the trustee, Graham Ship Repair Co. Such a claim is so

different in nature from the simple claim for contract indebtedness of the plaintiff that the two claims lack mutuality, in quality, and are not of a nature to be set-off. This is shown by the decision of the United States Supreme Court in *Western Tie and Timber Co.* v. *Brown*, 196 U. S. 502 (1905). There, Western Tie and Timber Co., hereinafter called Tie Co., was engaged in cutting lumber, employing a large number of workers. These workers bought groceries in stores owned by one Harrison. Harrison kept track of the supplies he sold to each employee, and gave a list of such indebtedness to the Tie Co. The Tie Co., in paying its employees, withheld the amount of money which the employees owed to Harrison, and remitted such withheld funds to Harrison. Harrison became bankrupt, owing the Tie Co. over $20,000.00. The Tie Co. had in its hands monies withheld from wages of its employees, in the amount of $2210.73, held out for Harrison. The Tie Co. attempted to set off the withheld monies, in its hands, against the indebtedness of Harrison to it, and made claim for the difference, after such set off, against Harrison, in his bankruptcy proceedings. The Supreme Court of the United States held that this could not be done, speaking in part as follows (pages 509-510):

> "This leaves only for consideration the question whether the tie company was entitled to prove its claim, as it sought to do, for the balance owing, after crediting as a set-off the 'deductions from pay rolls,' to which we have referred. Now, as we have seen, from the facts found, it must be that the agreement between Harrison and the tie company obligated the latter, when it made the deductions from pay rolls, to remit to Harrison the amount of such deductions irrespective of the account between itself and Harrison. It follows that as to such deductions the tie company stood towards Harrison in the relation of a trustee, and, therefore, the case was not one of mutual credits and debts within the meaning

of the set-off clause of the bankrupt law. Libby v. Hopkins, 104 U. S. 303."

Section 68 of the Bankruptcy Act of 1898, 11 U.S.C.A. Sec. 108, 30 Stat. 565, under which the above case was decided, provided in part:

> "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid."

The claim of the United States is solely against Graham Ship Repair Co., whereas the claim of Central Bank is solely against the United States; this diversity, as to the parties to the two claims, shows that these claims are not mutual claims, and are not the proper subject of set-off.

The applicable law as to this is well expressed by the Court of Errors and Appeals of New Jersey in *O'Dowd* v. *United States Fidelity and Guarantee Co.*, 117 N. J. Law 444, 189 Atl. 97 (1937), as follows (page 101):

> "The whole theory of the right of set-off 'rests in spirit and reason upon the avoidance of circuity of action by compelling the adjustment in one suit of all such mutual demands as are counterclaims.' Naylor v. Smith, 63 N. J. Law, 596, 598, 44 A. 649, 650. And the simple test of the mutuality of the demand is whether the defendant could recover against the plaintiff in an independent action."

The United States has no cause of action whatever against the petitioner Central Bank for or on account of the embezzlement of withheld tax monies by Graham Ship Repair Co. Under the law as to mutuality, it appears clear that there is no mutuality between the claim of petitioner against the United States, and the claim of the United States against Graham Ship Repair Co., as to parties; hence, the asserted set-off should not be allowed.

A note in the Yale Law Journal, Volume 60, Pages 548-553, issue of March, 1951, written with specific reference to this case, after pointing out the undesirable consequences of the decision of the Comptroller General which is here in question, indicated the law which should be deemed to be applicable, as follows (pages 551-552):

> "The 'no reduction' clause can be interpreted so as to avoid these results. At common law, the obligor on an assigned contract can set off against the assignee's claim obligations of the assignor arising subsequent to notice of the assignment only if they are part of the same transaction. The statutory clause merely extends this rule to prior claims. As to subsequent claims such as those involved in the *Graham* case, the clause should be interpreted to treat the Government exactly as if it were a private party. Reductions should be restricted to those claims which a private obligor could normally assert against an assignee; failure of consideration, breach of warranty, unsatisfactory work, and the like. Claims such as taxes, which accrue to the Government because it is the Government rather than because it is a contracting party, should be excluded under this test as 'independent of the contract.'"

The petitioner is an innocent third party assignee, for value, of the contract proceeds. Such assignment vested a legal security title to the contract proceeds in the petitioner. *Royal Indemnity Co.* v. *United States*, 117 Court of Claims 736, 93 Fed. Supp. 891, November 7, 1950; *Coconut Grove Exchange Bank* v. *New Amsterdam Cas. Co.*, 149 Fed. 2d 73, Circuit Court of Appeals, 5th Circuit, 1945. The United States has completely disregarded this valid security title of petitioner, and has illegally attempted to set-off its claim against Graham Ship Repair Co., against the contract proceeds, which are a fund belonging to the petitioner. The decided cases show that this attempt is completely outside of the law.

In *National Refining Co. v. United States*, 160 Fed. 2d 951, Circuit Court of Appeals, Eighth Circuit, 1947, the United States condemned a piece of property, and paid the total consideration into the registry of a Federal district court. Part of the total fund, to-wit, $1,519.75, represented a commission earned by one R. Newton McDowell. National Refining Co. claimed said commission fund, on the basis of an equitable assignment made to it by McDowell, and pointed to a final judgment of the highest court of Missouri, establishing such assignment. The United States claimed said commission fund, the basis for such claim being stated by the court as follows (pages 953-954):

> "The Government's claim to the fund is based upon a lien for unpaid federal taxes assessed against McDowell for the years 1935 to 1945. The lien was perfected in July, 1945, 'as against any mortgagee, pledgee, purchaser, or judgment creditor' (26 U.S.C.A. Int. Rev. Code, § 3672) by the recording of notices of tax lien. The Government also asserts the right to set off the fund against McDowell's unpaid taxes.
>
> * * * * * * *
>
> The Government argues: * * * (2) that the Government is entitled to set off the fund in the possession of the District Court against McDowell's unpaid taxes; and (3) that the provision of 26 U.S.C.A. Int. Rev. Code, § 3672 that a lien for taxes shall be invalid 'as against any mortgagee, pledgee, purchaser, or judgment creditor,' until notice is recorded, does not apply to appellant, because it was not a 'purchaser'."

The Eighth Circuit Court of Appeals held that National Refining Co. was entitled to the commission fund, speaking in part as follows (page 955):

> "No citation of authority is required to demonstrate that one may not set off against a debt a non-existent

obligation or *a fund belonging to someone other than the debtor.*" (Emphasis added.)

Accord: *In re Astoria Boulevard,* 171 Misc. 1018, 13 N.Y. Supp. 2d 433, New York Supreme Court, Queens County, 1939;

United States Fidelity & Guaranty Co. v. *Triborough Bridge Authority,* 297 N. Y. 31, 74 N. E. 2d 226, New York Court of Appeals, 1947;

Karno-Smith Co. v. *Maloney,* 112 Fed. 2d 690, Circuit Court of Appeals, Third Circuit, 1940;

United States v. *Rosebush,* 45 Fed. Supp. 664, District Court, Wisconsin, 1942.

In this regard, it must be remembered that the United States, as to its claim against Graham Ship Repair Co., is solely in the position of asserting an unsecured creditor's claim against the partners of Graham Ship Repair Co. *In re Frank,* 25 Fed. Supp. 1005, District Sourt, Southern District of New York, 1939.

The set-off which the United States asserts should not be allowed for another reason, which is that the claim it asserts as to Graham Ship Repair Co. does not arise under the contract at all, and it accrued long after the petitioner had taken its assignment of contract proceeds and had advanced the money, out of independent criminal acts of the partners of Graham Ship Repair Co. See *Northwestern Nat. Bank* v. *Commonwealth,* 345 Pa. 192, 27 A. 2d 20, Supreme Court of Pennsylvania, 1942. In this connection, it is to be noted that the Navy Department of the United States, after all contract adjustments, found that there was a balance due, *under the contract,* of $110,966.08 (R. 70).

The vital defect in the attempted set-off asserted by the United States is that the claim it asserts does not arise under the contract at all, but arises solely out of subsequent independent criminal fraud practiced by Graham Ship Repair Co. upon the United States. The petitioner had nothing whatever to do with the subsequent fraudulent acts of

Graham Ship Repair Co., and such acts should not be permitted to defeat the antecedent security rights of a third party bona fide purchaser.

Arlington Trust Co. v. *United States*, 100 Fed. Supp. 817, Court of Claims, November 6, 1951, is applicable. There, Arlington Trust Co. loaned money on war contracts to Leyde and Leyde, taking an assignment of the contract proceeds as security. Subsequently Leyde and Leyde put in a fraudulent claim against the United States, as to the contracts, thereby forfeiting their claim. The Court held, however, that the plaintiff Trust Company was in the position of an innocent purchaser for value, and that the subsequent fraud of the contractor on the United States should not be allowed to prejudice such innocent assignee. The Court spoke in part as follows (pages 818-819):

> "But the plaintiff here is a Trust Company, which, we suppose, loaned money to Leyde and Leyde, to finance the performance of the contracts in suit. It had no part in the fraud.
>
> * * * * * * *
>
> "The plaintiff is, presumably a purchaser in the sense that it loaned money to Leyde and Leyde when it took its assignments of the contracts. When we look at the purpose of the 1940 amendment to the Assignment of Claims Act, 31 U. S. Code 203, which was to enable contractors with the Government to obtain from private sources funds to finance their performance, we think it could not have been intended by Congress that the bank which loaned the money should take the risk that its collateral might, in an instant, be rendered worthless by the act of the contractor in committing fraud in the presentation of proof of his claim under the contract."

Accord: *Central Nat. Bank of Richmond, Va.* v. *United States*, 91 Fed. Supp. 738, Court of Claims, 1950.

The United States asserts the right of set-off upon the assumption that the claim of the United States against Graham Ship Repair Co. did not arise "independently of" Navy contract NObs-10230. This assumption is patently unfounded.

Graham Ship Repair Co. only became liable on such claim when it criminally embezzled and converted the trust res, to-wit, the taxmonies which it had withheld. It seems clear that such subsequent independent criminal acts of the contractor, Graham Ship Repair Company, should not prejudice a previous bona-fide assignee, for value, of the contract proceeds. Central Bank, the assignee had no control over Graham Ship Repair Company, and it was the United States which had extended trust to Graham Ship Repair Company, by making such company its own statutory agent to handle withheld Federal taxes. The normal assumption in the business world is that persons will act in accordance with law, and will commit no crimes. The commission of criminal acts by the contractor, long after the valid assignment to Central Bank, would clearly seem to be a matter arising independently of the contract. The relation of such embezzlements to the contract is indeed remote, and the plaintiff submits that the United States cannot reasonably compel a lending bank to guarantee the subsequent honesty and freedom from embezzlements of the contractor, under penalty of losing its security. Surely, the later intervention of felonious embezzlement by the contractor was a matter that the plaintiff could not guard against, and was a matter bearing no relation to the contract, upon objective appraisal.

In any event, the liabilities which the United States asserts can only be shown by application of the provisions of the Federal Internal Revenue Code to facts which all oc-

curred after Graham Ship Repair Company had assigned the contract proceeds, for value, to Central Bank.

The contract itself contains nothing which could, by any stretch of the imagination, give rise to such a liability.

The liability asserted is statutory, exists without reference to the contract, and could not be affected in any way by the provisions of the contract.

This is illustrated by the case of *United States* v. *Swedlow Engineering Co., Inc. & Fireman's Fund Indemnity Co.*, D. C., Southern District of California, October 24, 1951, reported in 1951 Prentice-Hall Federal Tax Service, Paragraph 72, 603. Here, the engineering company, performing a contract with the United States, had the indemnity company as surety on a bond, conditioned upon payment of labor and materials. The engineering company, being out of funds, asked the indemnity company to furnish payroll funds. This the indemnity company did, by putting up money with a bank, on pay day, with instructions to use the money to cover the payroll checks of the engineering company. The engineering company failed to withhold taxes, including Federal income taxes, Federal Insurance Contributions Act Taxes, and Federal Unemployment Taxes. Subsequently, the engineering company became bankrupt. The United States brought suit against the indemnity company, seeking to recover the amount of such taxes that were not withheld.

The court decided in favor of the United States, speaking in part as follows:

> "Here the 'trust fund' is created by statute (26 U.S.C.A. Section 3661). The bonding company paid the wages as they became due. Without the periodical drafts to cover them, they could not have have been paid. In the circumstances, the bonding company was 'the employer'. And the obligation to pay does not arise under the bond. It arises under the statutes of

the United States referred to. And the bond is merely the source under which the bonding company was substituted as the employer for the contractor who was in financial difficulties."

* * * * * * *

"The bonding company, by taking control of the payment of the wages, through the method described, became obligated under Sec. 1621(d)(1) of the Int. Rev. Code, to pay all the wages, including the portions to be withheld. Their failure to do so establishes their liability, not under the bond, but under the Internal Revenue Statute."

Speaking of the control of the payment of the wages, which the bonding company acquired, the court further said:

"With it passed the duty to withhold, imposed by the Internal Revenue statutes. The obligation which they failed to perform was that prescribed by these statutes. They are the basis of their liability and of the Government's claim. The limitations which apply are only those contained in the Internal Revenue Code."

When the contract proceeds were assigned, no one could predict or know whether or not Graham Ship Repair Company would or would not ever become obligated, under the Federal Internal Revenue Code, for any sums withheld as Federal taxes. Graham Ship Repair Company could have sub-contracted out the work, and never have had any liability at all; or, Graham Ship Repair Company, due to exemptions of its employees under the Internal Revenue Code, might have no liability whatever.

The question as to whether any liability of Graham Ship Repair Company for withholding of Federal taxes would ever arise depended completely upon (1) the provisions of

the Federal Internal Revenue Code, in force for periods of time *after* the assignment had been made, and (2) upon future states of facts, not humanly predictable, and the impact of the provisions of the Internal Revenue Code upon those facts.

The contract did not and could not validly deal, in any way, with the obligations of Graham Ship Repair Company as to withholding of Federal taxes, because such obligations were determinatively fixed by the Internal Revenue Code, and such obligations were completely independent of the contract and all of its provisions.

The defendant points to the coincidental fact that, by facts occurring subsequent to the assignment, Graham Ship Repair Company became liable for Federal withholding taxes with reference to wages paid to employees working on contract work. This liability clearly arises independently. The tenuous and factually coincidental connection upon which the defendant relies clearly arises independently, for it is to be remembered that not only does it arise as a statutory liability, but it also depends upon the subsequent occurrence of criminal acts of embezzlement by Graham Ship Repair Company.

The assignment of contract proceeds to Central Bank was made before any wages had been paid, and before any withholding of taxes had occurred. If, prior to the payment of wages by Graham Ship Repair Company, the withholding of taxes provisions of the Internal Revenue Code had been repealed, this would not have made one iota of difference as to the contract or its performance; nothing could more clearly demonstrate that the liability the United States asserts is purely statutory, and completely untouched by the contract or the contract provisions.

The United States passed the Assignment of Claims Act

of 1940 to induce banks to lend, safely and freely, upon the assignment of war contracts. This was done to help the war effort. The plaintiff bank loaned money, in reliance upon this Act, on the war contract here involved. In so doing, the bank relied upon the clear wording and meaning of the Statute, and made the reasonable interpretation that claims for taxes, against the contractor, accruing subsequent to the assignment, did not dilute or defeat the banks assignment and security rights.

The United States obtained the financing which it desired.

Having achieved this, the United States now evolves a technical, strained, and unsound theory for the construction of the Assignment of Claims Act of 1940, in an effort to defeat the security rights of the plaintiff bank in the assigned contract proceeds.

The position that the United States adopts, in this situation, is strikingly inequitable.

The adoption of such a position, by a private business concern, in an equivalent situation, would very quickly achieve for such concern a reputation for sharp practice and unconscionable dealing.

The adoption of such a position by the United States is unworthy of our great country. The vitally important factor as to the adoption of such a position is that it shakes the faith of private business concerns in the business integrity of the United States. Viewed realistically, we know that the United States may have to fight again, to defend itself, and, for her very life. Under our private enterprise system, this must inevitably involve private financing as to Government contracts. One outstanding precious asset that the United States has enjoyed, in all past contingencies, is an unblemished reputation for business integrity. To preserve and keep that reputation intact is a matter that merits the most thoughtful and careful consideration.

With a view to the best interests of the United States, the petitioner submits that this Court should grant the writ of certiorari.

Respectfully submitted,

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APPENDIX

Revised Statutes:

Sec. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. * * *

Sec. 3737. No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

Assignment of Claims Act of 1940, c. 779, 54 Stat. 1029:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department

thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency:

Provided,

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department of agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in

such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

* * * * * * *

31 U. S. C. 1946 ed., Sec. 203; 41 U. S. C. 1946 ed., Sec. 15.)

INTERNAL REVENUE CODE

Sec. 1401.

(a) Requirement.—The tax imposed by section 1400 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.

(b) Indemnification of Employer.—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against any claims and demands of any person for the amount of any such payment made by such employer.

* * *

Sec. 1622.

(a) Requirement of Withholding.—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 18 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b) (1), except that in the case of wages paid on or after November 1, 1951, and before January 1, 1954, the tax shall be equal to 20 per centum of such excess in lieu of 18 per centum.

* * *

Sec. 1623.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment.

Sec. 3661.

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to

pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

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Supreme Court of the United States

October Term, 1952

No. 521

CENTRAL BANK, a Corporation, *Petitioner*

vs.

THE UNITED STATES, *Respondent*

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR PETITIONER

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WILSON - EPES PRINTING CO. - RE 7-6009 - WASHINGTON 1, D. C.

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BRIEF FOR PETITIONER

OPINION BELOW

The opinion of the Court of Claims (R. 75-79) is reported in 105 Fed. Supp. 992.

JURISDICTION

This is a proceeding to review a judgment of the Court of Claims, entered July 15, 1952 (R 79).

Jurisdiction is conferred on this Court by Section 1255, Title 28, United States Code (62 Stat. 928).

Certiorari was granted by this Court on March 9th, 1953.

STATEMENT OF THE CASE

The essential facts are not in dispute; they are briefly as follows:

The petitioner is a California Banking Corporation, engaged in the banking business at all of the times involved in this suit (R. 68).

On December 30, 1944, Graham Ship Repair Company, a partnership, entered into a contract, NOBs—10230, with the Navy Department of the United States for ship repair work (R. 10-56; 69); Article 15 (b & c) of this contract authorized Graham Ship Repair Co. to assign monies due or to become due to it, under said contract, to any bank, as security (R. 34-35).

Graham Ship Repair Co. arranged with petitioner that petitioner should advance funds to it, to enable Graham Ship Repair Co. to carry out said ship repair contract; on January 31, 1945, Graham Ship Repair Co. assigned all monies due or to become due to it, under said contract, to petitioner, as security for funds so advanced and to be advanced by petitioner (R. 56-58; 69). This assignment was made under and pursuant to the provisions of the Assignment of Claims Act of 1940, 54 Stat. 1029 (R. 58; 69).

After the execution of said assignment, petitioner did loan substantial sums of money to Graham Ship Repair Co. to pay for labor and material costs of ship repairs performed by Graham Ship Repair Co. under said Navy contract NOBs-10230 (R. 70).

Graham Ship Repair Co. withheld $453,469.55 withholding tax and $11,462.91 Federal Unemployment Tax, from the salaries and wages of its employees engaged in the ship repair work under said Navy contract NOBs-10230; these amounts were withheld by Graham Ship Repair Co. under the requirements of Sections 1401 and 1622 of the Internal Revenue Code. Graham Ship Repair Co. failed to pay over to the Collector of Internal Revenue said sums withheld, and converted the same to its own use (R. 70). Because of this, no further ship

repair job orders were given to Graham Ship Repair Co., after March 31, 1946; the partners of Graham Ship Repair Co. were indicted and convicted of wilful attempt to evade payment of said withheld tax monies (R. 70).

At termination of said contract, there was due, for work performed under it, the sum of $110,966.08; at that time, also, Graham Ship Repair Co. was indebted to petitioner for amounts in excess of $110,966.08, for monies advanced by petitioner to Graham Ship Repair Co. to pay for labor and material costs of said ship repair contract (R. 70).

At termination of said contract, Graham Ship Repair Co. was liable to the United States for the withheld tax monies it had converted, plus penalties and interest as to same, in the total sum of $616,750.95 (R. 70).

Petitioner claimed the amount due under said Navy contract, $110,966.08, under the assignment to it by Graham Ship Repair Co. The Commissioner of Internal Revenue also claimed said balance of $110,966.08, to apply upon the aforesaid tax liabilities of Graham Ship Repair Co. (R. 71).

The Comptroller General of the United States ruled that said tax claims of the United States, against Graham Ship Repair Co., could be set-off against the amount of $110,966.08, due and owing under said Navy contract NOBs-10230, and administratively effected said set-off (R. 71).

In December, 1946, the Commissioner of Internal Revenue duly assessed against Graham Ship Repair Co. the amounts due from it as to withheld but unpaid tax monies, and duly filed and recorded liens against Graham Ship Repair Co. for such tax monies (R. 71).

SPECIFICATION OF ERROR TO BE URGED

The error is that the right of the petitioner to its security for money loaned, in assigned contract proceeds, as against subsequently arising claims of the United States against the contractor for criminal embezzlement of withheld tax monies, is completely clear, and that the denial of such security by the court below is patently erroneous.

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ARGUMENT

POINT I

The History of the Assignment of Claims Act of 1940 Shows Clear Legislative Intent to Protect Financing Assignee Banks, in the Position of Central Bank, from Liabilities to the United States Which Arise Out of the Subsequent Independent Acts of the Contractor Committed Apart from the Performance of the Contract.

Prior to the passage of the Assignment of Claims Act of 1940, two Federal statutes prohibited the assignment of contracts with the United States, or interests therein (41 U. S. Code, Section 15 and 31 U. S. Code, Section 203; set out infra, Appendix II, page 34).

Said two statutes were amended by the Assignment of Claims Act of 1940 (54 Stat. 1029; set out infra, Appendix II, pages 34-36) Said amendment permitted assignment of such contracts to a bank or financing institution, and further provided as follows:

> "Any contract entered into by the War Department or the Navy Department may provide that payments to any assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract."

Speaking of the no set-off provision above quoted, while it was being debated by the United States Senate, Senator Barkley explained such amendment, as follows (Congressional Record, 76th Congress, Page 12803):

> "Mr. President, the amendment merely provides that when a contractor, in order to obtain money so that he may perform his contract with the Government under the defense program, assigns his contract

to a bank or trust company in order to get money with which to proceed with the work, it shall not be permissible to offset against the claim or contract later an indebtedness which the contractor may owe the Government on account of some other contract or *some other situation.*" (Emphasis added.)

Hearings were held on the Assignment of Claims Act of 1940, before the Senate Committee on Banking and Currency. In the hearing held September 14, 1940, 76th Congress, 3rd Session, Senator Barkley spoke in part as follows (Report of Hearings, page 2):

> "The object of this proposed legislation is to remove the restrictions on these two Sections referred to regarding the assignment of contracts with the Government. The main purpose is to permit contractors who may not have enough working capital—and this particularly affects small contractors—to go ahead with Government contracts; so that if they have to go to the bank and borrow money, they can assign the contract as security and then can get the money and go ahead with the work; then when the work is completed and the Government is ready to pay the contractor, naturally the bank has a *first* claim on it." (Emphasis added.)

POINT II

In Passing the Assignment of Claims Act of 1940 in Order to Get Private Financing for Contractors on War Contracts, the United States Acted in its Business Capacity, To Effect Commercial Transactions; the Rules of Law that Govern Individuals in Such Commercial Transactions Should Be Applied; Such Rules of Law Show that the Set-off Asserted by the United States Should Not Be Allowed.

When the United States passed the Assignment of Claims Act of 1940, in order to get private financing for contractors working on war contracts, the United States

acted in its business capacity, to effect commercial transactions; this means that the United States should be held bound by the same rules of law that govern individuals in such transactions.

In *United States* v. *Seaboard Air Line Ry. Co.*, 22 Fed. 2d 113 (1927), the Circuit Court of Appeals for the Fourth Circuit, in holding that the United States was fully subject to the general rules of commercial law, as to a Bill of Lading to which it was a party, spoke in part as follows (Page 115):

> "And the rule is well settled that, when the 'government * * * comes down from its position of sovereignity, and enters the domain of commerce, it submits itself to the same laws that govern individuals there.' Cooke vs. U. S., 91 U. S. 389, 398, 23 L. Ed. 237; Standard Oil Co. v. U. S., 267 U. S. 76, 45 S. Ct. 211, 69 L. Ed. 519; Chesapeake & Delaware Canal Co. v. U. S., 250 U. S. 123, 126, 39 S. Ct. 407, 63 L. Ed. 889; U. S. v. Bank of Metropolis, 15 Pet. 377, 392, 393, 10 L. Ed. 774; U. S. v. Barker, 12 Wheat. 559, 6 L. Ed. 728; England Nat. Bank v. U. S. (C. C. A. 8th) 282 F. 121."

Accord: United States v. *National Exchange Bank*, 270 U. S. 527, 46 S. Ct. 388 (1926, where Mr. Justice Holmes spoke in part as follows (Page 389):

> "The United States does business on business terms. Cooke v. United States, 91 U. S. 389, 23 L. Ed. 237."

A note in the Yale Law Journal, Volume 60, Pages 548-553, issue of March, 1951, written with specific reference to this case, after pointing out the undesirable consequences of the decision of the Comptroller General which is here in question, indicated the law which should be deemed to be applicable, as follows (pages 551-552):

> "The 'no reduction' clause can be interpreted so as to avoid these results. At common law, the obligor on an assigned contract can set off against the as-

signee's claim obligations of the assignor arising subsequent to notice of the assignment only if they are part of the same transaction. The statutory clause merely extends this rule to prior claims. As to subsequent claims such as those involved in the *Graham* case, the clause should be interpreted to treat the Government exactly as if it were a private party. Reductions should be restricted to those claims which a private obligor could normally assert against an assignee; failure of consideration, breach of warranty, unsatisfactory work, and the like. Claims such as taxes, which accrue to the Government because it is the Government rather than because it is a contracting party, should be excluded under this test as 'independent of the contract.'"

The set-off which the United States asserts should not be allowed because the claim it asserts as to Graham Ship Repair Co. does not arise under the contract at all, and it accrued long after the plaintiff had taken its assignment of contract proceeds and had advanced the money, out of independent criminal acts of the partners of Graham Ship Repair Co. See: *Northwestern Nat. Bank vs. Commonwealth*, 345 Pa. 192, 27 A. 2d 20, Supreme Court of Pennsylvania, 1942.

In this connection, it is to be noted that the Navy Department of the United States, after all contract adjustments, found that there was a balance due, *under the contract*, of $110,966.08 (R 70).

POINT III

The General Commercial Law Applicable Shows That the Claim of the United States As to Taxes Against Graham Ship Repair Co. Is Not the Proper Subject of Set-off As to the Claim of Central Bank for Contract Proceeds.

57 Corpus Juris, on *Set-Off and Counterclaim*, Section 95, pages 444-445, states the applicable law as follows:

> "* * *, it is a broad general rule of practically universal application that to warrant a set-off the demands must be mutual and subsisting between the same parties, and furthermore must be due in the same capacity or right, and there must be mutuality as to the quality of the right."

The tax monies withheld by Graham Ship Repair Co. being held in trust for the United States, the claim of the United States is really a claim as the beneficiary of a trust, arising out of the criminal embezzlement of the trust res by the trustee, Graham Ship Repair Co. Such a claim is so different in nature from the simple claim for contract indebtedness of the petitioner that the two claims lack mutuality, in quality, and are not of a nature to be set-off. This is shown by the decision of the United States Supreme Court in *Western Tie and Timber Co. vs. Brown*, 196 U. S. 502 (1905). There, Western Tie and Timber Co., hereinafter called Tie Co., was engaged in cutting lumber, employing a large number of workers. These workers bought groceries in stores owned by one Harrison. Harrison kept track of the supplies he sold to each employee, and gave a list of such indebtedness to the Tie Co. The Tie Co., in paying its employees, withheld the amount of money which the employees owed to Harrison, and remitted such withheld funds to Harrison. Harrison became bankrupt, owing the Tie Co. over $20,000.00. The Tie Co. had in its hands monies withheld from wages of its employees, in the amount of $2210.75, held out for Harrison. The Tie Co. attempted to set off the withheld monies in its hands, against the indebtedness of Harrison to it, and made claim for the difference, after such set off, against Harrison, in his bankruptcy proceedings. The Supreme Court of the United States held that this could not be done, speaking in part as follows (pages 509-510):

> "This leaves only for consideration the question whether the tie company was entitled to prove its

claim, as it sought to do, for the balance owing, after crediting as a set-off the 'deductions from pay rolls,' to which we have referred. Now, as we have seen, from the facts found, it must be that the agreement between Harrison and the tie company obligated the latter, when it made the deductions from pay rolls, to remit to Harrison the amount of such deductions irrespective of the account between itself and Harrison. It follows that as to such deductions the tie company stood towards Harrison in the relation of a trustee, and, therefore, the case was not one of mutual credits and debts within the meaning of the set-off clause of the bankrupt law. Libby v. Hopkins, 104 U. S. 303."

Section 68 of the Bankruptcy Act of 1898, 11 U.S.C.A. Sec. 108, 30 Stat. 565, under which the above case was decided, provided in part:

"In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid."

The claim of the United States is solely against Graham Ship Repair Co., whereas the claim of Central Bank is solely against the United States; this diversity, as to the parties to the two claims, shows that these claims are not mutual claims, and are not the proper subject of set-off.

The applicable law as to this is well expressed by the Court of Errors and Appeals of New Jersey in *O'Dowd* vs. *United States Fidelity and Guarantee Co.*, 117 N. J. Law 444, 189 Atl. 97 (1937), as follows (page 101):

"The whole theory of the right of set-off 'rests in spirit and reason upon the avoidance of circuity of action by compelling the adjustment in one suit of all such mutual demands as are counterclaims.' Naylor v. Smith, 63 N. J. Law, 596, 598, 44 A. 649, 650. And the simple test of the mutuality of the demand

is whether the defendant could recover against the plaintiff in an independent action."

The United States has no cause of action whatever against Central Bank for or on account of the embezzlement of withheld tax monies by Graham Ship Repair Co. Under the law as to mutuality, it appears clear that there is no mutuality between the claim of petitioner against the United States, and the claim of the United States against Graham Ship Repair Co., as to parties; hence, the asserted set-off should not be allowed.

POINT IV

The Facts Show that the Claim of the United States Arises Out of the Subsequent Independent Criminal Acts of Embezzlement Committed by Graham Ship Repair Company.

The petitioner took an assignment of the Navy contract between Graham Ship Repair Co. and the United States, on January 31, 1945, and loaned Graham Ship Repair Co. the monies that enabled it to carry out the ship repair contract.

Such Navy contract (R. 10-56) is completely silent as to any obligations on the part of Graham Ship Repair Co. to withhold taxes from its employees, and pay the same over to the United States.

Sections 1401 and 1622 of the Internal Revenue Code did impose such obligations on Graham Ship Repair Co., and Graham Ship Repair Co. did in fact make such withholdings.

In this situation, the Federal statute delineating the right and duty of Graham Ship Repair Co. was Section 3661 of the Internal Revenue Code, which read as follows:

> "'Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States."

The petitioner submits that the obligation of Graham Ship Repair Co. was not a contract indebtedness, but that Graham Ship Repair Co., as to tax monies it withheld, acted as a trustee for the United States, and held such monies, as trustee, under Section 3661 of the Internal Revenue Code, above set forth. Apart from such trust fund so held, Graham Ship Repair Co. was not indebted to the United States, as to such tax monies. General indebtedness of Graham Ship Repair Co. to the United States, as to such monies, only arose when Graham Ship Repair Co. criminally embezzled the trust res. Such criminal embezzlement was something that had no relation to the contract, and could not possibly have been foreseen or guarded against.

It is true that where an employer does not withhold at all, he becomes generally indebted for the amounts he should have withheld, under Section 1623 of the Internal Revenue Code. This is not the situation in the case at bar, as here the employer did in fact withhold. Having done this, the trust provision of Section 3661 of the Internal Revenue Code immediately was applicable. At this point, Graham Ship Repair Co. was not "indebted" to the United States, but simply was a trustee, owing the duty to turn over the trust res to the United States. This is shown by the consideration that, with such trust fund intact, the United States would have no cause of action at all for a general indebtedness; rather, its sole remedy would be in equity, to compel the trustee to turn over to it the trust res. Subsequently, when Graham Ship Repair Co. embezzled the trust res, it then became generally liable to the United States for the amount of the

embezzlement. These considerations show that the claim of the United States only arises from the subsequent independent criminal act of embezzlement by Graham Ship Repair Co.

The Court of Claims completely lost sight of the nature of the obligation of Graham Ship Repair Co., which was for criminal embezzlement of trust funds, and this contributed to the erroneous judgment of that Court.

POINT V

The Valid Assignment to Central Bank of the Contract Proceeds Vested Legal Title to Such Proceeds in Central Bank, Protecting Central Bank Against Subsequently Arising Claims of the United States for and on Account of Embezzlements of Tax Monies by the Assignor.

The petitioner is an innocent third party assignee, for value, of the contract proceeds. Such assignment vested a legal security title to the contract proceeds in the petitioner.

In *Royal Indemnity Co.* v. *United States*, 117 Court of Claims 736, 93 Fed. Supp. 891, United States Court of Claims, November 7, 1950, the court considered the effect of the assignment, by a contractor with the United States, to a bank, under and pursuant to the Assignment of Claims Act of 1940. The opinion of the majority of the court, speaking, in part, as to this, is as follows (Page 894):

> "The contractor's assignment on May 7, 1945, of all his claims under the contract to the bank as security for credit to be advanced and used for the financing of the contract work complied in every respect with the Assignment of Claims Act of 1940, supra. The bank thus took good legal title to the contract proceeds."

In *Coconut Grove Exchange Bank* v. *New Amsterdam Cas. Co.*, 149 Fed. 2d 73, Circuit Court of Appeals, Fifth Circuit, 1945, the court construed the amendment made by the Assignment of Claims Act of 1940, speaking in part as follows (page 77):

> "The amendment made valid that which had heretofore been void and if it were intended not to affect any rights between the parties relating to the validity of such contracts, why did the Act contain the provision that '*Notwithstanding any law to the contrary* governing the validity of assignments any assignment pursuant to this paragraph and the following paragraph shall constitute a valid assignment *for all purposes*'? (Emphasis added.) If an assignment is valid as to the Government but invalid against the Surety and others, could it be said to be 'valid for all purposes'? If the amendment was only for the protection of the Government, why does it provide that *the Government could not reduce the assigned claim or set it off by any claim that it has against such an assignor?* In addition to protecting the Government, which was the prime purpose of the section before its amendment, as construed in *Martin v. National Surety Co.*, 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822, the amendment of 1940 had the incidental effect of protecting that assignee who filed his assignment and gave notice under the provisions of the statute." (Emphasis added)

The United States has completely disregarded this valid security title of plaintiff, and has illegally attempted to set-off its claim against Graham Ship Repair Co., against the contract proceeds, which are a fund belonging to the plaintiff. The decided cases show that this attempt is completely outside of the law.

In *National Refining Co.* v. *United States*, 160 Fed. 2d 951, Circuit Court of Appeals, Eighth Circuit, 1947, the United States condemned a piece of property, and paid the total consideration into the registry of a Federal district court. Part of the total fund, to-wit, $1,519.75, rep-

resented a commission earned by one R. Newton McDowell. National Refining Co. claimed said commission fund, on the basis of an equitable assignment made to it by McDowell, and pointed to a final judgment of the highest court of Missouri, establishing such assignment. The United States claimed said commission fund, the basis for such claim being stated by the court as follows (pages 953-954):

> "The Government's claim to the fund is based upon a lien for unpaid federal taxes assessed against McDowell for the years 1935 to 1945. The lien was perfected in July, 1945, 'as against any mortgagee, pledgee, purchaser, or judgment creditor' (26 U.S.C.A. Int. Rev. Code, § 3672) by the recording of notices of tax lien. The Government also asserts the right to set off the fund against McDowell's unpaid taxes.
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> • • • •
>
> The Government argues: * * * (2) that the Government is entitled to set off the fund in the possession of the District Court against McDowell's unpaid taxes; and (3) that the provision of 26 U.S.C.A. Int. Rev. Code, § 3672 that a lien for taxes shall be invalid 'as against any mortgagee, pledgee, purchaser, or judgment creditor,' until notice is recorded, does not apply to appellant, because it was not a 'purchaser'."

The Eighth Circuit Court of Appeals held that National Refining Co. was entitled to the commission fund, speaking in part as follows (page 955):

> "No citation of authority is required to demonstrate that one may not set off against a debt a nonexistent obligation or *a fund belonging to someone other than the debtor.*" (Emphasis added)

Accord: *In re Astoria Boulevard*, 171 Misc. 1018, 13 N. Y. Supp. 2d 433, New York Supreme Court, Queens County, 1939.

United States Fidelity & Guaranty Co. vs. Triborough Bridge Authority, 297 N. Y. 31, 74 N. E. 2d 226, New York Court of Appeals, 1947.

Karno-Smith Co. vs. Maloney, 112 Fed. 2d 690, Circuit Court of Appeals, Third Circuit, 1940.
United States vs. Rosebush, 45 Fed. Supp. 664, District Court, Wisconsin, 1942.

In this regard, it must be remembered that the United States, as to its claim against Graham Ship Repair Co., is solely in the position of asserting an unsecured creditor's claim against the partners of Graham Ship Repair Co. *In re Frank*. 25 Fed. Supp. 1005, District Court, Southern District of New York, 1939.

POINT VI

As Central Bank Is a Bona-Fide Purchaser for Value of the Contract Proceeds, the Subsequent Independent Criminal Fraud of the Contractor Should Not Work Forfeiture of the Banks Security Title.

The vital defect in the attempted set-off asserted by the United States is that the claim it asserts does not arise under the contract at all, but arises solely out of subsequent independent criminal fraud practiced by Graham Ship Repair Co. upon the United States. The petitioner had nothing whatever to do with the subsequent fraudulent acts of Graham Ship Repair Co., and such acts should not be permitted to defeat the antecedent security rights of a third party bona fide purchaser.

Arlington Trust Co. vs. United States, 100 Fed. Supp. 817, Court of Claims, November 6, 1951, is applicable. There, Arlington Trust Co. loaned money on war contracts to Leyde and Leyde, taking an assignment of the contract proceeds as security. Subsequently, Leyde and Leyde put in a fraudulent claim against the United States, as to the contracts, thereby forfeiting their claim. The Court held, however, that the plaintiff Trust Company was in the position of an innocent purchaser for value,

and that the subsequent fraud of the contractor on the United States should not be allowed to prejudice such innocent assignee. The Court spoke in part as follows (pages 818-819):

> "But the plaintiff here is a Trust Company, which, we suppose, loaned money to Leyde and Leyde, to finance the performance of the contracts in suit. It had no part in the fraud.
>
> * * * * *
>
> "The plaintiff is, presumably a purchaser in the sense that it loaned money to Leyde and Leyde when it took its assignments of the contracts. When we look at the purpose of the 1940 amendment to the Assignment of Claims Act, 31 U. S. Code 203, which was to enable contractors with the Government to obtain from private sources funds to finance their performance, we think it could not have been intended by Congress that the bank which loaned the money should take the risk that its collateral might, in an instant, be rendered worthless by the act of the contractor in committing fraud in the presentation of proof of his claim under the contract."

In *Central Nat. Bank of Richmond, Virginia* v. *United States*, 91 Fed. Supp. 738, United States Court of Claims, 1950, one Kent contracted with the United States, in 1945. Kent borrowed money, to carry out the contract, from Central National Bank of Richmond, and, pursuant to the Assignment of Claims Act of 1940, assigned all payments due or to become due under the contract to the said bank. The contract provided for such assignment. The bank gave proper notification, pursuant to the Assignment of Claims Act of 1940. Despite such notification, the United States erroneously made payment, direct to Kent, in the amount of $11,193.55. Kent held the Government check for a time, then cashed it and used the proceeds for his own purposes. The United States refused to pay said sum of $11,193.55 to Central National Bank of Richmond. The bank brought suit to recover same.

The court held in favor of the plaintiff, speaking in part as follows (page 740):

> "Prior to the enactment of the Assignment of Claims Act of 1940, 31 U. S. C. A. § 203, assignments such as the one with which we are here dealing were expressly declared void by law. The 1940 act was intended to facilitate emergency financing of the vast war program and designed to permit established lending institutions to provide immediate funds for contracts incident to the war effort. This very purpose of the act is aptly described in its title:
>
> 'An Act
>
> 'To assist in the national-defense program by amending sections 3477 and 3737 of the Revised Statutes to permit the assignment of claims under public contracts.'
>
> * * * * *
>
> "That Congress intended to validate the very kind of assignment here involved 'notwithstanding any law to the contrary governing the validity of assignments' is perfectly obvious.
>
> "Furthermore, the effect of such enactment was to place the Government in the same position as that of any ordinary debtor. *United States* v. *Standard Rice Co.*, 323 U. S. 106, 65 S. Ct. 145, 89 L. Ed. 104. When a question regarding assignments as they affect the Government arises, the general law of assignments must govern.
>
> "Plaintiff's assignment was made pursuant to the Act of 1940 and notice thereof was given in the manner and to the officials as required. Having so complied with the act, plaintiff is entitled to that degree of protection ordinarily given to an innocent assignee who acts in good faith."

It is to be noted that, in the above case, Kent embezzled and/or converted part of the contract payments, to his own use, thereby coming under an immediate liability to the United States to repay such sums so embezzled by him. Hence, said case is similar to the case at bar, where the Grahams embezzled monies which they should

have turned over to the United States. In the case at bar, said embezzlement was remote, so far as the contract was concerned. In the *Central National Bank of Richmond* case, the embezzlement was of the contract proceeds themselves. Accordingly, the *Central National Bank of Richmond* case is an à fortiori precedent, demonstrating the right of the petitioner to recover in the case at bar.

POINT VII

The Claim of the United States Arose Under the Internal Revenue Code, Out of Criminal Acts of Graham Ship Repair Company Occurring After the Assignment of Contract Proceeds To Central Bank; Such Claim Arose Independently of the Contract.

The claim which the United States asserts arises out of the application of the Internal Revenue Code to subsequent acts of Graham Ship Repair Co. Graham Ship Repair Co. only became liable on such claim when it criminally embezzled and converted the trust res, to-wit, the tax monies which it had withheld. It seems clear that such subsequent independent criminal acts of the contractor, Graham Ship Repair Company, should not prejudice a previous bona fide assignee, for value, of the contract proceeds. Central Bank, the assignee, had no control over Graham Ship Repair Company, and it was the United States which had extended trust to Graham Ship Repair Company, by making such company its own statutory agent to handle withheld Federal taxes. The normal assumption in the business world is that persons will act in accordance with law, and will commit no crimes. The commission of criminal acts by the contractor, long after the valid assignment to Central Bank, would clearly seem to be a matter arising independently of the contract. The relation of such embezzlements to the contract is indeed remote, and the petitioner submits that the United States

cannot reasonably compel a lending bank to guarantee the subsequent honesty and freedom from embezzlements of the contractor, under penalty of losing its security. Surely, the later intervention of felonious embezzlement by the contractor was a matter that the petitioner could not guard against, and was a matter bearing no relation to the contract, upon objective appraisal.

In any event, the liabilities which the United States asserts can only be shown by application of the provisions of the Federal Internal Revenue Code to facts which all occurred after Graham Ship Repair Company had assigned the contract proceeds, for value, to Central Bank.

The contract itself contains nothing which could, by any stretch of the imagination, give rise to such a liability.

The liability asserted is statutory, exists without reference to the contract, and could not be affected in any way by the provisions of the contract.

This is illustrated by the case of *United States* v. *Swedlow Engineering Co., Inc. & Fireman's Fund Indemnity Co.*, D. C., Southern District of California, October 24, 1951, reported in 1951 Prentice-Hall Federal Tax Service, Paragraph 72, 603. Here, the engineering company, performing a contract with the United States, had the indemnity company as surety on a bond, conditioned upon payment of labor and materials. The engineering company, being out of funds, asked the indemnity company to furnish payroll funds. This the indemnity company did, by putting up money with a bank, on pay day, with instructions to use the money to cover the payroll checks of the engineering company. The engineering company failed to withhold taxes, including Federal income taxes, Federal Insurance Contributions Act Taxes, and Federal Unemployment Taxes. Subsequently, the engineering company became bankrupt. The United States brought

suit against the indemnity company, seeking to recover the amount of such taxes that were not withheld.

The court decided in favor of the United States, speaking in part as follows:

> "Here the 'trust fund' is created by statute (26 U.S.C.A. Section 3661). The bonding company paid the wages as they became due. Without the periodical drafts to cover them, they could not have been paid. In the circumstances, the bonding company was 'the employer'. And the obligation to pay does not arise under the bond. It arises under the statutes of the United States referred to. And the bond is merely the source under which the bonding company was substituted as the employer for the contractor who was in financial difficulties."
>
> * * * * *
>
> "The bonding company, by taking control of the payment of the wages, through the method described, became obligated under Sec. 1621(d)(1) of the Int. Rev. Code, to pay all the wages, including the portions to be withheld. Their failure to do so establishes their liability, not under the bond, but under the Internal Revenue Statute."

Speaking of the control of the payment of the wages, which the bonding company acquired, the court further said:

> "With it passed the duty to withhold, imposed by the Internal Revenue statutes. The obligation which they failed to perform was that prescribed by these statutes. They are the basis of their liability and of the Government's claim. The limitations which apply are only those contained in the Internal Revenue Code."

When the contract proceeds were assigned, no one could predict or know whether or not Graham Ship Repair Company would or would not ever become obligated, under the Federal Internal Revenue Code, for any sums withheld as Federal taxes. Graham Ship Repair Com-

pany could have sub-contracted out the work, and never have had any liability at all; or, Graham Ship Repair Company, due to exemptions of its employees under the Internal Revenue Code, might have no liability whatever.

The question as to whether any liability of Graham Ship Repair Company for withholding of Federal taxes would ever arise depended completely upon (1) the provisions of the Federal Internal Revenue Code, in force for periods of time *after* the assignment had been made, and (2) upon future states of facts, not humanly predictable, and the impact of the provisions of the Internal Revenue Code upon those facts.

The contract did not and could not validly deal, in any way, with the obligations of Graham Ship Repair Company as to withholding of Federal taxes, because such obligations were determinitively fixed by the Internal Revenue Code, and such obligations were completely independent of the contract and all of its provisions.

The respondent points to the coincidental fact that, by facts occurring subsequent to the assignment, Graham Ship Repair Company became liable for Federal withholding taxes with reference to wages paid to employees working on contract work. This liability arises independently. The tenuous and factually coincidental connection upon which the defendant relies clearly arises independently, for it is to be remembered that not only does it arise as a statutory liability, but it also depends upon the subsequent occurrence of criminal acts of embezzlement by Graham Ship Repair Company.

The assignment of contract proceeds to Central Bank was made before any wages had been paid, and before any withholding of taxes had occurred. If, prior to the payment of wages by Graham Ship Repair Company, the withholding of taxes provisions of the Internal Revenue Code had been repealed, this would not have made one

iota of difference as to the contract or its performance; nothing could more clearly demonstrate that the liability the United States asserts is purely statutory, and completely untouched by the contract or the contract provisions.

POINT VIII

Concepts of Fairness and Honesty in Business Dealings Show That the Innocent Financing Bank Should Be Protected in its Security Against the Subsequently Arising Claims of the United States Against the Contractor for Criminal Embezzlement of Withheld Tax Monies.

The United States passed the Assignment of Claims Act of 1940 to induce banks to lend, safely and freely, upon the assignment of war contracts. This was done to help the war effort. The petitioner bank loaned money, in reliance upon this Act, on the war contract here involved. In so doing, the bank relied upon the clear wording and meaning of the Statute, and made the reasonable interpretation that claims relating to taxes, against the contractor, accruing subsequent to the assignment, did not dilute or defeat the banks assignment and security rights.

This was the view of the Comptroller General of the United States. In 20 Decisions of the Comptroller General 458 (1941), the Federal Farm Security Administration proposed to make loans to persons who had contracts with the United States War and Navy Departments, for sale or lease of land to such Departments. The Farm Security Administration asked the United States Comptroller General for his opinion, as to whether or not the United States could set-off such loans, in cases where the borrowers had previously assigned the contract proceeds under the Assignment of Claims Act of 1940. The Comp-

troller General ruled in the negative, speaking in part as follows:

> "In the event of a valid assignment pursuant to the Assignment of Claims Act of 1940, Public, No. 811, approved October 9, 1940, made prior to the date of the making of a loan by the Farm Security Administration it would appear that the right of set-off would not be available to the Farm Security Administration as against the assignee of monies due under the contract assigned. While an assignee acquires no greater rights through an assignment than his assignor had at the time of the assignment, and takes the assignment subject to any existing right of set-off, his rights under the assignment are not affected by independent claims subsequently accruing in favor of the Government against his assignor. That is to say, a debtor cannot set off rights acquired under other transactions subsequent to the date of receipt of notice of a valid assignment."

This construction and interpretation of the assignment of Claims Act of 1940 was made by the Comptroller General of the United States in 1941, before Central Bank loaned money to Graham Ship Repair Company, and took assignment of the contract. It clearly indicated the general understanding, as to protection of an assignee who advanced money under the Assignment of Claims Act of 1940, against subsequently accruing claims of the Government against the contractor.

The United States obtained the financing which it desired.

Having achieved this, the United States subsequently evolved a technical, strained, and unsound theory for the construction of the Assignment of Claims Act of 1940, in an effort to defeat the security rights of the petitioner bank in the assigned contract proceeds.

The position that the United States adopts, in this situation, is strikingly inequitable.

The adoption of such a position, by a private business concern, in an equivalent situation, would very quickly achieve for such concern a reputation for sharp practice and unconscionable dealing.

The adoption of such a position by the United States is unworthy of our great country. The vitally important factor as to the adoption of such a position is that it shakes the faith of private business concerns in the business integrity of the United States.

The strained and unsound theory for the construction of the Assignment of Claims Act advanced by the United States in this suit should be rejected, or the adoption of it would result in an inequitable defeat of the security rights of an innocent private assignee, Central Bank, which advanced money in reliance upon the clear wording and meaning of the Statute, as hereinbefore shown.

CONCLUSION

For all of the foregoing reasons, the judgment of the Court of Claims should be reversed, and the case remanded for entry of an appropriate judgment protecting the petitioner in its security.

Respectfully submitted,

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APPENDIX I

Discussion of the Precedents Cited by the Court of Claims in its Opinion of July 15, 1952

The Court of Claims cited the following four cases in its opinion of July 15, 1952 (R. 76, 78). The petitioner respectfully submits that these cases are inapplicable and do not support the judgment of the Court of Claims, and in that regard makes the following analysis of them:

In *Modern Industrial Bank vs. United States,* 101 Court of Claims 808, the contractor defaulted in the performance of its contract, and the United States terminated the contract because of the default. The financing bank, assignee of the contract proceeds, sought to recover the full contract price, based on percentage of completion, without regard to the money damage caused to the United States by the contractor's default. The holding of the court was that the damage caused by the contractor's breach of the contract should be deducted from the amounts otherwise payable under the contract. This is a clear case, and completely sound. It does not apply to the case at bar, however, because in the *Modern Industrial Bank* case the damage to the United States arose directly out of breach of the contract itself; in the case at bar, the damage caused to the United States did not arise under the contract at all, but arose out of the subsequent, independent criminal embezzlements of the tax monies, by the contractor, in violation of the Internal Revenue Code and of Federal criminal statutes.

In *United States vs. Munsey Trust Co.,* 322 U. S. 234, 67 Supreme Court 1599 (1947), the plaintiff claimed contract proceeds in the right of a surety company which had taken an assignment of such proceeds as surety. The surety company had been forced to pay sundry unpaid claims for labor and material. However, there was no statute authorizing such an assignment of contract pro-

ceeds to a surety, and accordingly the surety had no true security at all, and was simply in the position of a general creditor as to the contract proceeds. This being so, the United States, which also had a general creditors' claim was entitled to use set-off to pay itself. The case at bar is very different. The assignment to Central Bank was specifically authorized by the Assignment of Claims Act of 1940; Central Bank had a valid assignment of the contract proceeds, and was a secured creditor. The claim against Graham Ship Repair Co. (which the United States asserts) is a general creditor's claim. Such claim, arising after the security to Central Bank had become effective, and arising out of the independent criminal acts of the contractor, is not the proper subject of set-off against the secured claim of Central Bank. There is nothing in the holding in the *Munsey Trust Co.* case which supports the position of the respondent, and the petitioner respectfully submits that said case is inappropos.

Seaboard Surety Co. vs. United States, 108 Court of Claims 759, 67 Fed. Supp. 969 (1946) makes a holding essentially similar to the holding in the *Munsey Trust Co.* case. The rationale and language of the Court in the *Seaboard Surety Co.* case strongly support the position of the plaintiff in the case at bar. The essential fact in the *Seaboard Surety Co.* case was that the surety company did not have a valid assignment of contract proceeds, and hence had no security; in the case at bar, Central Bank had a valid assignment, and was in the position of a bona fide secured creditor.

Royal Indemnity Company vs. United States, 117 Court of Claims 736, 93 Fed. Supp. 891 (1950) involving a preexisting equitable lien upon contract proceeds, held by a surety company. The holding of the court was that such preexisting equitable lien took precedence over a subsequent assignment of the contract proceeds to a financing bank, under the Assignment of Claims Act of 1940. It

is to be noted that the financing bank took its assignment with full notice and knowledge of the preexisting equitable lien and rights of the surety company. In addition, the equitable lien of the surety company was a valid security, as between itself and any other private claimant. The *Royal Indemnity Company* case is markedly different from the case at bar. In the case at bar, Central Bank loaned money and took the assignment of contract proceeds at a time when there was no claim whatever by the United States in existence; Central Bank thus became a bona fide secured creditor, and the subsequently arising general creditors claim of the United States, arising out of the independent criminal acts of the contractor, does not constitute the proper subject matter of set-off as against the preexisting security taken in good faith by Central Bank.

APPENDIX II

Revised Statutes:

Sec. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment,

read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same.

* * *

Sec. 3737. No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

Assignment of Claims Act of 1940, c. 779; 54 Stat. 1029:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency:

Provided,

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts pay-

able under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

(31 U.S.C. 1946 ed., Sec. 203; 41 U.S.C. 1946 ed., Sec. 15.)

INTERNAL REVENUE CODE

Sec. 1401.

(a) REQUIREMENT.—The tax imposed by section 1400 shall be collected by the employer of the taxpayer, by

deducting the amount of the tax from the wages as and when paid.

(b) INDEMNIFICATION OF EMPLOYER.—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against any claims and demands of any person for the amount of any such payment made by such employer. * * *

Sec. 1622.

(a) REQUIREMENT OF WITHHOLDING.—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 18 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b) (1), except that in the case of wages paid on or after November 1, 1951, and before January 1, 1954, the tax shall be equal to 20 per centum of such excess in lieu of 18 per centum. * * *

SEC. 1623.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment.

SEC. 3661.

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

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Supreme Court of the United States

October Term, 1952

No. 521

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vs.

THE UNITED STATES, *Respondent*

On Writ of Certiorari to the United States Court of Claims

REPLY BRIEF FOR PETITIONER

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WILSON - EPES PRINTING CO. - RE 7-6003 - WASHINGTON 1, D. C.

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I.

WITHHELD TAXES ARE NOT A PART OF WAGES

The respondent in its brief seems to argue that the taxes withheld by Graham Ship Repair Company were a part of unpaid wages. Thus, the respondent says (Resp. Br. p. 8) that "* * * the tax indebtedness was an indivisible part of the obligation to pay wages * * *". This argument is amplified by the respondent on page 13 of its brief, as follows: "Stated another way, a portion of

the wages which accrued in performing the contract had to be paid directly to the Government." Again, on page 15 of its brief the respondent says that "* * * the tax obligation was an indispensible ingredient of the obligation to pay wages * * *."

This attempt to attribute to the tax monies withheld the character of unpaid wages is completely unsound.

In *United States Fidelity and Guaranty Co.* v. *United States*, 201 F. (2d) 118, United States Court of Appeals, Tenth Circuit, 1952, the United States contracted with Leavell & Co. for the construction of a building. Leavell & Co. subcontracted part of the work to Kendrick Electric Co., Inc., hereinafter called Kendrick. United States Fidelity & Guaranty Company executed a surety bond for Kendrick, guaranteeing payment of all obligations of Kendrick under the subcontract. Kendrick assigned to said surety company, as security, all payments and monies to which it might become entitled under the contract. Kendrick defaulted in making sundry payments due under the subcontract for materials, supplies and equipment. Kendrick also withheld income taxes and social security taxes out of wages paid by it to its employees engaged in performance of the subcontract, and failed to pay such withheld taxes over to the United States. Leavell & Co. made demand upon United States Fidelity & Guaranty Company, as surety for Kendrick, to pay the unpaid bills for materials, supplies and equipment, and the surety company paid these bills. At that time there was due to Kendrick from Leavell & Co. on the subcontract, $4,960.24. The surety company claimed the right to said sum under its assignment of contract proceeds made by Kendrick. The United States asserted a right to said sum, to apply upon the liability of Kendrick to the United States for income and social security taxes withheld by Kendrick and not paid over to the United States.

The trial court decided this issue in favor of the United States; it did this upon the theory that the taxes withheld by Kendrick constituted wages; that the failure to pay these taxes constituted a breach by Kendrick of its obligation to pay all wages; hence, that the surety company was obligated to pay said withheld taxes, as being part of unpaid wages.

The surety company appealed to the United States Court of Appeals for the Tenth Circuit. On this Appeal, the United States argued the same theory that the trial court had adopted, as set forth. The Tenth Circuit Court of Appeals reversed. The majority of the Court spoke in part as follows:

> "In its conclusions of law the trial court held that Kendrick agreed to and accepted full and exclusive liability for the payment of these withholding taxes and that it was obligated to the United States for their payment and that under the surety company's bond for the performance of Kendrick's obligations it became liable for their payment.
>
> "It is true that in Paragraph 12 of the sub-contract Kendrick assumed and accepted 'full and exclusive liability for the payment of any and all contributions or taxes for Unemployment Insurance and/or Old Age Retirement Benefit, Pensions, or Annuities, * * *' imposed by the Government and measured by the wages paid to its employees. But this did not create the liability or Kendrick's part for the payment of these taxes. It was merely declaratory of Kendrick's existing liability under the federal tax laws." (p. 119)
>
> * * * *
>
> "* * * It is thus clear that Kendrick's liability for the payment of these taxes arises by virtue of law and not because of any contractual acknowledgment of the existly legal liability." (p. 120)
>
> * * * *
>
> "* * * However, from the statutes and regulations as set out it seems clear that when an employer with-

holds the tax from an employee's wage and pays him the balance the employee has been paid in full. He has received his full wage. Part of it has gone to pay his withholding tax and the balance he has. The employer has discharged his contractual obligation to pay the full wage. Thereafter there remains only his liability for the tax which he has collected. That is a tax liability for which he alone is liable to the Government as for any other taxes which he may owe." (p. 120)

• • • • •

"Finally it is contended that the Government's lien for these taxes is superior to the surety's claim to these funds. This contention has been decided against the Government in a series of cases. As pointed out in the application for the payment bond, Kendrick assigned to the surety company all its right title and interest in and to any funds it was entitled to receive from the principal contractor, Leavell, to indemnify it against liability to which it might become subjected by virtue of Kendrick's breach of its construction subcontract. At the time the surety company became liable and discharged its liability by paying all material, supply and labor claims, the fund in question was due Kendrick from Leavell. When surety is called upon and makes good under its contract of suretyship upon default of its principal, it acquires an equitable lien against any sum remaining in the hands of the one for whose protection the bond was written due to its principal upon discharge of his obligation under its bond. This equitable lien relates back to the date of the contract and is superior to a Government lien for unpaid taxes subsequent to the date of the contract of suretyship although prior to the date of payment by the surety." (p. 121).

• • • •

In this case, the assignment of contract proceeds by Kendrick to the surety company was valid. However, said assignment could not protect the surety company as to claims arising under or related to the contract, because the surety company was obligated by its bond to

perform all of Kendrick's obligations under the subcontract. Therefore, the decision of the Tenth Circuit Court of Appeals that the liabilities of Kendrick to the United States for withheld taxes were statutory liabilities, and not contractual liabilities, amounts to a holding that the said liabilities for withheld tax monies arose *independently of the contract.*

Accord: *United States v. Swallow Engineering Co., Inc. & Firemen's Fund Indemnity Co.*, 100 F. Supp. 796, now on appeal to the United States Court of Appeals, Ninth Circuit. See also *Grasso v. Oehmann* (1947) 54 A (2d) 570, Municipal Court of Appeals, D. C.

The issue decided by the Tenth Circuit Court of Appeals in the United States Fidelity & Guaranty Company case is thus closely parallel to the issue presented in the case at bar and the case appears to be persuasive, to the effect that liability of a contractor for embezzlement of withheld taxes is an indebtedness arising independently of the contract.

II.

THE 1951 AMENDMENTS TO THE ASSIGNMENT OF CLAIMS ACT OF 1940, IN THE LIGHT OF THE LEGISLATIVE HISTORY OF THE AMENDING ACT, ARE DECLARATORY OF THE TRUE MEANING AND SENSE OF THE STATUTE.

The respondent, in its brief, calls attention to the 1951 amendments of the Assignment of Claims Act of 1940 (set forth in Respondent's Brief, App. p. 42-45), and takes the position that those amendments constituted a modification of the 1940 Act and not a clarification of it (Respondent's Brief, pp. 26-31). The respondent further argues that such amendment thus indicates that the Assignment of Claims Act of 1940 did not preclude setoff of taxes, such as the ones involved in the case at bar.

Although the amending Act contains the specific provision "Except as herein otherwise provided, nothing in this Act, as amended, shall be deemed to affect or impair rights or obligations heretofore accrued", a consideration of the legislative history of the amending Act shows that the rulings of the Comptroller General in this and other cases as to the construction to be given the Assignment of Claims Act of 1940 had completely destroyed the effectiveness of that Act and had made it impossible for that Act to accomplish the very purpose for which it was enacted; that the urgency for inducing banks to finance small contractors for essential defense work was so imperative that something had to be done immediately; that affirmative action could not be delayed until judicial review of the Comptroller's rulings could be concluded; and that the amendments which specifically referred to the subject matter of those rulings and made those rulings inoperative, was enacted to make certain that the Assignment of Claims Act of 1940 would accomplish what it was originally intended to accomplish.

The situation is shown by Senator Robertson's report, to the Senate, for the Senate Committee on Banking and Currency, as to the proposed 1951 Amendment (82d Congress, 1st Session, Senate, Report No. 217 p. 2). He spoke in part as follows:

> "It had also been the understanding of banks that the statute protected them against set-off by the Government on account of any claims by the Government against the contractor arising outside of the terms of the assigned contract. However, in an opinion dated May 15, 1950, the Comptroller General ruled that claims by the Government against a contractor on account of unpaid social-security contributions and withheld income taxes were claims which did not arise independently of the assigned contract.
>
> "These and other similar rulings of the Comptroller General to the same effect have operated to

deter banks from making loans to Government contractors on the security of assignments of claims because of uncertainty as to the nature and extent of other indebtedness of a contractor to the Government, such as liability resulting from renegotiation or unpaid income taxes, on account of which the Government might later reduce payments due to the assignee bank, or recover payments already made. As a result, the current V-loan program has been seriously retarded; and many of the smaller contractors having a large volume of Government contracts but a small net worth are presently unable to obtain the financing necessary to enable them to perform their contracts."

The Report also sets forth an expression of the views of the Office of Defense Mobilization (p. 5) which reads in part as follows:

"However, certain recent rulings by the Comptroller General, which have in effect limited the *intended* scope of the Assignment of Claims Act, have resulted in a general unwillingness on the part of commercial banks to undertake defense production financing. One such ruling relates to the right of the Government to recover payments previously made to the assignee bank. Another creates some uncertainty concerning the right of set-off on the part of the Government. The banks do not consider such matters as the usual commercial risks which they are willing to accept. Accordingly, they feel they should not be held liable for actions beyond their control or for amounts not commensurate with the risk." (Emphasis added)

The Report of the Committee on the Judiciary, of the House of Representatives, is to the same effect (82d Congress, 1st. Session, House of Representatives, Report No. 376, at pages 1-3). In that Report, Congressman Lane spoke in part as follows (p. 1):

"The Assignment of Claims Act of 1940 was enacted for the purpose of inducing private financing

institutions to participate in the financing of defense contractors under the defense program of that period.

"Under this statute, banks were able to finance defense contractors on the security of such assignments of claims where other forms of security were not available and guaranteed loans made under the very successful V-loan program of World War II were generally secured in this manner.

"However, within the last year and a half the Comptroller General in certain opinions has held that payments already made to an assignee bank pursuant to the Assignment of Claims Act may subsequently be recovered by the Government on account of an overpayment due to price revision and that certain types of claims of the Government against a contractor, *which had previously been regarded as claims arising 'independently' of the assigned contract*, might be set off by the Government in making payments to an assignee bank. Because of these opinions, the banking institutions are reluctant to make this type of loans, with the result that many defense contractors—especially the smaller manufacturers and producers—are presently unable to obtain the necessary financing for the performance of their defense contracts." (Emphasis added.)

While the 1951 amendment is in terms not retroactive and has no direct application to the case at bar, nevertheless the petitioner submits that the legislative history of the amendment may properly be consulted as a guide to the intention of Congress in previously enacting the Assignment of Claims Act of 1940.

The above Reports show that the intention of the Assignment of Claims Act of 1940 was to protect the financing banks against set-off for subsequently accruing liabilities of the contractor which did not arise directly out of the performance of the contract and that such had been the general understanding of the matter in the business world. These things are demonstrtaed in the hearings before Subcommittee No. 4 of the Committee

on the Judiciary, House of Representatives, 82d Congress, First Session, held March 7, March 21 and April 12, 1951, relating to the proposed 1951 Amendment. In those hearings the general counsel to the Board of Governors of the Federal Reserve System said in part as follows (p. 4):

> "In the second place, banks had understood that the 'no set-off' provision of the statute protected them from a reduction of payments due under an assigned contract on account of any claims of the Government against the contractor except claims arising under the terms of the contract itself. The Comptroller General, however, has held that claims of the Government against the contractor for unpaid social-security contributions or withheld income taxes of its employees are claims which arise out of the assigned contract rather than independently of the contract, and that, therefore, they may be set off against the payments due an assignee bank. Such an interpretation of the statute suggests the possibility that the Government might also attempt to reduce payments owing to an assignee bank because of some other indebtedness of the contractor to the Government, such as liability for renegotiation or even for unpaid income or excess profit taxes of the contractor.
>
> "We would like to emphasize at this point that we are not attempting to comment upon the legal correctness or incorrectness of the various rulings of the Comptroller General on this subject. The question is not whether the rulings are legally justified. Our concern is with the effect that the rulings are having upon the program for guaranteed loans and therefore upon the effectiveness of the financing of defense production, particularly by the smaller contractors.
>
> "Banks and other financing institutions are unwilling—and can hardly be expected—to assume the abnormal risks of loss which are imposed upon them by these rulings. Consequently, in many cases they are refusing to make loans to the small marginal businesses on the security of assignments of claims. The

larger contractors—the prime credit risks—are not suffering. It is the little contractor, without any adequate collateral security to offer except an assignment of his defense contracts, who is finding it difficult or impossible to obtain needed financing."

Other portions of these hearings are to the same effect (pages 9, 22, 40, 42, 64, and 70).

The effect of the 1951 amendment in the light of its legislative history, as to the Assignment of Claims Act of 1940, was "merely declaratory of the true meaning and sense of the statute"; *Wetmore v. Markoe*, 196 U.S. 68, 25 S. Ct. 172.

The petitioner believes that in the presentation of its case in its opening brief, it has adequately answered all other points and contentions advanced by respondent in its brief.

CONCLUSION

It is respectfully submitted that the Assignment of Claims Act of 1940 was made for the specific purpose of encouraging banking institutions to loan money to contractors and to assure banks that they could rely upon assignments of contract proceeds as security for their loans, protected against all claims of the Government against the contractor excepting such claims which arise directly under the contract; that claims for taxes withheld by the contractor were not intended by Congress, nor generally understood by the business world, as being a type of indebtedness arising under the contract; that an indebtedness arising out of an embezzlement by the contractor of withheld tax monies held by him in trust for the United States was an indebtedness entirely unrelated to the contract and arising independently of the contract; and that the Court of Claims, in reaching the

conclusion that such indebtedness was an indebtedness arising under the contract, committed error which should be reversed.

Respectfully submitted,

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FILED
FEB 26 1953
HAROLD B. WILLEY, Clerk

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 75-79) is reported at 105 F. Supp. 992.

JURISDICTION

The judgment of the Court of Claims (R. 79) was entered on July 15, 1952. A motion for a new

trial was filed August 13, 1952, and was overruled October 7, 1952. (R. 79.) The petition for a writ of certiorari was filed December 30, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1255(1).

QUESTION PRESENTED

Payments under a Navy contract were assigned by the contractor to petitioner under R. S. 3477 and 3737, as amended. The contract provided that payments thereunder to an assignee should not be subject to reduction or set-off for indebtedness of the assignor to the United States arising independently of the contract. The contractor in the performance of the contract withheld from the wages and salaries of its employees appropriate amounts to cover their income and social security taxes, but failed to pay such amounts over to the Government. The Comptroller General declined to authorize payment to the assignee of the final amount due from the United States under the contract, but instead set off that amount against the taxes withheld but not paid by the contractor, on the ground that the Government's claim for said taxes did not arise independently of the contract.

The question presented is whether the United States could legally make the set-off as against the assignee.

STATUTES INVOLVED

The applicable statutes are set forth in the Appendix, *infra*, pp. 15-18.

STATEMENT

The special findings of fact of the Court of Claims (R. 73-75) may be summarized as follows:

Petitioner, a California corporation, was during the years involved, and is now, engaged in the banking business. (R. 73.)

On December 30, 1944, the Graham Ship Repair Company (hereinafter sometimes referred to as "Graham") a partnership having its place of business in Oakland, California, entered into a contract with the Navy Department of the United States for certain ship repair work. After the execution of such contract, Graham arranged with petitioner for the financing of the work to be performed under the contract and as security for the funds to be advanced assigned to petitioner the proceeds payable under the contract. This assignment was made pursuant to the provisions of R.S. 3477 and 3737, as amended by the Assignment of Claims Act, 54 Stat. 1029, 31 U.S.C. 203; 41 U.S.C. 15, *infra*, pp. 16-18. The Contracting Officer, Bureau of Ships, Navy Department, the Disbursing Officer and the General Accounting Office were duly notified of the assignment as required by the Act. (R. 73.)

After the execution of the assignment, petitioner advanced to Graham substantial sums of money for use in the performance of the contract. During the course of the performance of the contract, certain administrative officers of the Government ascertained that the contractor had failed to pay over and remit to the Collector of Internal Revenue sums of $453,469.55, representing withholding taxes, and $11,462.91, representing federal unemployment taxes, which the contractor had withheld from salaries and wages of its employees engaged in the performance of the Navy contract. Sections 1401 and 1622 of the Internal Revenue Code required Graham as an employer to make these withholdings, but instead of paying over those amounts to the Collector of Internal Revenue the contractor converted them to its own use. Because of this dereliction on the part of the contractor, no further job orders were issued to it under the contract after March 31, 1946, and the contract was terminated. The individuals composing the Graham Ship Repair Company partnership were indicted in the United States District Court for the Northern District of California, Southern Division, under Section 2707(c) of the Internal Revenue Code (26 U.S.C. 2707(c)), for willful attempt to evade and defeat the payment of the withheld taxes, and they entered pleas of guilty to the charge. (R. 73-74.)

At the time the contract was terminated, Graham

was indebted to the Government for the unpaid withholding taxes above referred to, which with interest and penalties aggregated $616,750.95. At that time, the sum of $110,966.08 was due Graham, the contractor, for work performed under the contract. Also at that time, Graham was indebted to petitioner in an amount in excess of $110,966.08, for advances made by petitioner pursuant to the assignment. (R. 74.)

Because of the outstanding taxes due from Graham, the Commissioner of Internal Revenue filed a claim with the Navy Department for the balance due under the contract, and since petitioner also claimed such balance under the assignment agreement, the conflicting claims were referred by the Navy Department to the General Accounting Office for direct settlement. (R. 74.)

By decision dated May 18, 1950, the Comptroller General of the United States ruled that the sum of $110,966.08 due Graham was a proper set-off against the taxes due from Graham, and that official therefore denied petitioner's claim. Thereafter, by the issuance of appropriate certificates of settlement, the Comptroller General effected the set-off, thereby reducing the tax indebtedness of Graham to $415,018.17, which for purposes of this case the petitioner admits is still outstanding and unsatisfied. In December 1946, the Commissioner of Internal Revenue made appropriate assessments of the taxes

due from Graham and thereafter, in December 1946, the Collector of Internal Revenue at San Francisco filed liens against that taxpayer for such taxes, which liens were duly recorded. (R. 74-75.)

The Court of Claims rendered judgment for the United States, holding that the set-off made by the Comptroller General was legal and proper and that petitioner was not, therefore, entitled to recover under the assignment (R. 75-79).

ARGUMENT

The precise question presented is whether the tax debt due from the contractor to the United States arose independently of its contract with the Navy, within the meaning of the following provision of the Assignment of Claims Act of 1940, *infra*, p. 18:

> Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

1. Petitioner contends (Pet. 9-10) that the tax debt had no relation to the Navy's contract with its assignor, but arose independently of that contract. The contention is without merit.

The court below found (R. 73) that the tax debt of the contractor arose because of its failure to pay over to the Collector of Internal Revenue certain amounts which it had withheld from the salaries and wages of its employees who were engaged in the performance of the Navy contract from which petitioner's assignment derived. Thus, it is beyond question that the tax obligation depended for its existence upon the contract, for if there had been no contract, no taxes would have become due and no liability would have accrued. There is, of course, no question here of an allocation of the taxes with respect to employees who worked on other contracts either all or part of the time. Hence, the taxes were not only related to the particular Navy contract but they owed their existence to it.

Petitioner contends (Pet. 6, 9-10) that the contractor's debt for taxes grew out of the criminal embezzlement of the funds withheld from its employees, and that it was not therefore a contract indebtedness. This contention ignores the fact that no obligation arose under the pertinent taxing statutes until services were performed under the contract and salaries and wages were paid for such services. It was not until the salaries and wages were due for services performed that any obligation devolved upon the contractor to withhold a portion of the amounts due. The contract could not have been performed without giving

rise to the very debt now in question, and the conclusion appears inescapable that the tax debt did not arise independently of such contract. Hence, the tax obligation did not arise out of the embezzlement by the contractor of the tax funds but came into existence by reason of the impact of the taxing provisions upon the performance of the contract. While the failure of the contractor to satisfy the tax obligation became a conversion, the withholding tax obligation had arisen before the conversion and was directly dependent upon the performance of the contract. The fact that the failure of the partnership contractor to pay over to the Government the withholding taxes subjected the members of that partnership to criminal liability for which they were duly tried and convicted, plainly has nothing whatever to do with the question whether the obligation to pay over to the Government the sums withheld from the employees who worked on the contract, arose out of the contract.

The decision of the court below is in accord with the provisions of the Assignment of Claims Act of 1940, *infra*, pp. 16-18, which permit the assignment of the proceeds of Government contracts within certain limitations.

Prior to the enactment of the Assignment of Claims Act, all assignments of claims against the United States (with exceptions not here material) were declared by statute to be null and void.

Sections 3477 and 3737, Revised Statutes (*infra*, pp. 15-16). However, in 1940 Congress became aware of the fact that the application and enforcement of these restrictive provisions would be prejudicial to the defense effort and a bill was introduced in Congress (H.R. 10464, 76th Cong., 3d Sess.) amending those sections to permit the assignment of the proceeds of a Government contract to a bank, trust company or financing institution, including any federal lending agency, as security for advances or loans to aid in the performance of a contract. During the debate on the bill in the Senate, an amendment to the bill was offered by Senator Barkley, which later became, in substantially the same language, the paragraph of the Assignment of Claims Act of 1940, quoted above (*supra*, p. 6) and which precluded the Government from making set-offs of claims arising independently of the contract involved as against an assignee. Senator Barkley explained that the purpose of his amendment was to assist in the defense program by permitting contractors —particularly small contractors—to obtain funds with which to perform Government contracts and assign the proceeds of the contracts as security for loans. The Senator said in part (86 Cong. Rec., p. 12803):

> * * * it shall not be permissible to offset against the claim or contract later an indebtedness which the contractor may owe the

Government on account of some other contract or some other situation.

It is plain, therefore, from the legislative history of Senator Barkley's amendment that the restriction on set-offs against assignees was intended to apply only in connection with "some other contract or some other situation," or as the Senator further explained (also at 86 Cong. Rec., p. 12803), "something which had no relationship to the contract or to the defense program." In sum, the restriction placed on the Government by the amendment is limited strictly to claims which have no relationship whatever to the pertinent contract. The court below has so applied the provision in its prior decisions. See *Modern Industrial Bank* v. *United States*, 101 C. Cls. 808; *Royal Indemnity Co.* v. *United States*, 117 C. Cls. 736; and *Rhode Island Discount Co.* v. *United States*, 118 C. Cls. 262.

2. Petitioner's reliance upon the general law of assignments and the equities of the situation is misplaced. Neither of these doctrines supports its position in this case. The assignment here involved was made pursuant to an exception from the general provisions of R. S. 3477 and 3737, as amended by the Assignment of Claims Act of 1940, *infra*, pp. 16-18, without which exception the assignment would have been null and void. The reach of the assignment is therefore subject to the

limitations prescribed by the Amendatory Act which authorized the assignment and gave validity to it. In the circumstances, petitioner must accept all of the provisions of that Act, including the provision which protects the assignee against set-offs only in connection with claims that arise apart from and independently of the particular contract.

So far as the general law of assignments is concerned, the Government clearly did not exceed its rights in refusing to pay the assignee in this case. The Government was not a mere stakeholder but was the owner of the fund to be disbursed, and there was a debt due it from the contractor. Hence, it had a clear right to set off amounts due it against amounts which it owes. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239. As this Court said in that case (p. 240), a creditor in the position of the Government in this case "is the best secured of creditors; his security is his own justified refusal to pay what he owes until he is paid what is due him."

With respect to the equities of the situation, the Government has merely enforced the provisions of the contract which the Gover. ment entered into with the contractor. Article 15(c) of the contract provides that (R. 35):

> Payments to an assignee of any claims arising under this contract shall not be sub-

> ject to reduction or set-off for any indebtedness of the Contractor to the Government arising independently of this contract.

In view of the foregoing provision of the contract, the petitioner must have realized that any amounts to which it should be entitled as assignee would be subject to invasion for any debts of the contractor to the Government arising in connection with the performance of the contract. And since, as we have shown (*supra*, pp. 7-8), the debt of the contractor was directly connected with the performance of the contract, petitioner has no cause for complaining that it has been unfairly treated by the Government.

Petitioner is in no worse position than a surety who has been obliged to pay laborers and materialmen because of the contractor's default. In such a case, the right of the Government to offset the contract balance against taxes due from the contractor is definitely established, notwithstanding any equities in favor of the surety. *United States* v. *Munsey Trust Co.*, 332 U.S. 234; *Schmoll, Successor* v. *United States*, 105 C. Cls. 415.

It is axiomatic that an assignee has no greater rights than those of the assignor and, therefore, were it not for the specific restriction in the Assignment of Claims Act of 1940, the Government would undoubtedly have the power to set off any debt due to it by the contractor of whatever character and however it arose, as against sums

due the assignee. But this Act limits such set-offs to indebtedness relating to the contract, and it is from this provision alone that the assignee may have protection against that general right.

It was implicit in the assignment in the instant case that the assignee should receive only those sums under the contract to which the contractor would be entitled, giving due effect, of course, to the restrictive provisions of the Assignment of Claims Act. Therefore, since the contractor would not have been entitled to the sum here sought because of tax indebtedness to the Government and because indebtedness did not arise independently of the contract but was directly related thereto, the petitioner is not entitled to recover.

CONCLUSION

The decision of the Court of Claims is correct, there is no conflict of decisions, and the case does not warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEBRUARY, 1953.

APPENDIX

Revised Statutes:

SEC. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgements of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgement, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. * * *

(31 U.S.C. 1946 ed., Sec. 203.)

SEC. 3737. No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

(41 U.S.C. 1946 ed., Sec. 15.)

Assignment of Claims Act of 1940, c. 779, 54 Stat. 1029.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: *Provided,*

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

* * * *

(31 U.S.C. 203; 41 U.S.C. 15.)

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No. 521

In the Supreme Court of the United States

OCTOBER TERM, 1952

CENTRAL BANK, A CORPORATION, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 521

CENTRAL BANK, A CORPORATION, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 75-79) is reported at 105 F. Supp. 992.

JURISDICTION

The judgment of the Court of Claims was entered on July 15, 1952. On August 13, 1952, petitioner filed a motion for a new trial. The motion was overruled on October 7, 1952. (R. 79.) The petition for certiorari was filed on December 30, 1952, and was granted on March 9, 1953 (R. 80). The jurisdiction of this Court rests upon 28 U.S.C. 1255.

QUESTION PRESENTED

A government contractor assigned the proceeds of his contract to a bank pursuant to the Assignment of Claims Act of 1940. As authorized by that Act, the contract provided that payments to the assignee shall not be subject to set-off for an indebtedness of the contractor arising independently of the contract. The contractor failed to pay federal income and social security taxes which it withheld from the wages of its employees engaged in performing the contract work. The question is whether the contractor's tax indebtedness is, within the meaning of the 1940 Act, an indebtedness "arising independently of such contract," which may not be set-off against moneys owed by the Government on the contract.

STATUTES INVOLVED

The pertinent provisions of the following statutes are set forth in the Appendix, *infra*, pp. 40-47: the Anti-Assignment Statute (R.S. 3477, 31 U.S.C. 203, 1934 Ed.); the Assignment of Claims Act of 1940 (54 Stat. 1029, 31 U.S.C. 203); the Act of May 15, 1951 (65 Stat. 41, 31 U.S.C. Supp. V, 203); the offset statutes (28 U.S.C. 1503; 31 U.S.C. 71); and Sections 1400, 1401, 1622(a), 1623 and 3661 of the Internal Revenue Code (26 U.S.C.).

STATEMENT

Graham Ship Repair Company, a partnership, of Oakland, California, entered into a contract with the Navy Department on December 30, 1944, for ship repair work (R. 73). The contract was for the

period of the war plus six months but could be terminated sooner by the Navy, upon a determination that termination would be for the best interests of the Government (R. 46, 48). As permitted by the Assignment of Claims Act of 1940, 54 Stat. 1029, 31 U.S.C. 203, *infra*, pp. 40-42, the contract had a provision authorizing the contractor to assign the proceeds of the contract to a bank (R. 34) and payments to the assignee bank were not to be "subject to reduction or set-off for any indebtedness of the Contractor to the Government arising independently of this contract" (R. 35).

After entering into the contract, the contractor made an assignment of the expected proceeds of the contract to petitioner, a bank at Oakland, California, to secure a loan made by petitioner to finance the work. The assignment was made on January 31, 1945. R. 73, 56-58. The Contracting Officer, the Disbursing Officer, and the General Accounting Office were duly notified of the assignment, as required by the Assignment of Claims Act, and all acknowledged receipt of notice in February 1945 (R. 73, 58-62).

Petitioner advanced substantial sums of money to the contractor to pay for labor and material costs in connection with the work under the contract. During the course of performance, the contractor withheld the sums of $453,469.55, for income taxes, and $11,462.91, for federal unemployment taxes, from the salaries and wages of its employees who were doing the work called for by the contract. Sections 1401 and 1622 of the Internal

Revenue Code required the contractor, as an employer, to make these withholdings. Instead of paying these amounts to the Collector of Internal Revenue, the partners of the contracting firm converted the money to their own use. (R. 73.) Because of the contractor's failure to pay the amounts withheld, the Navy declined to issue further job orders to the contractor after March 31, 1946, and terminated the contract (R. 74, 76). The partners of the contracting firm were later indicted, under Section 2707 (c) of the Internal Revenue Code, and pleaded guilty to charges of a willful attempt to evade and defeat the payment of the taxes withheld (R. 74).

When the contract was terminated, the contractor's indebtedness to the Government for unpaid withholding taxes, with interest and penalties, aggregated $616,750.95. At that time, the Government owed the contractor, for work performed under the contract, the sum of $110,966.08. (R. 74.)

Petitioner, as assignee, made claim for the balance due from the Government under the contract. The Commissioner of Internal Revenue also claimed that amount. By decision dated May 18, 1950, the Comptroller General ruled that the sum of $110,966.08 due the contractor was a proper set-off against the contractor's tax indebtedness,

---

[1] In December 1946, the Commissioner of Internal Revenue made appropriate assessments of the taxes due from the contractor and after that, in the same month, the Collector of Internal Revenue at San Francisco filed liens against the contractor for such taxes, which liens were duly recorded. (R. 74-75.)

and therefore denied petitioner's claim. (R. 74, 62-67.) Thereafter, by the issuance of appropriate Certificates of Settlement, the Comptroller General effected the aforesaid set-off and in that way reduced the contractor's tax indebtedness to $415,018.17 (R. 74). This suit by petitioner followed.

The Court of Claims rendered judgment for the United States, holding that the set-off was proper, that the tax indebtedness arose by reason of and in connection with the assignor's performance of work under the contract, that the petitioner knew its assignor was required to withhold and pay taxes, that the tax obligation was directly associated with the contract, and that, therefore, the indebtedness did not arise independently of such contract within the meaning of the Assignment of Claims Act of 1940 (R. 75-79).

ARGUMENT

Introduction and Summary

A. Petitioner's assignor owed to the Government the amount of income and federal unemployment taxes which it had withheld pursuant to I.R.C. 1401 and 1622 from the salaries and wages of its employees who were engaged in the performance of the Navy contract (R. 73). Whether the Government has surrendered its right to set off such an indebtedness depends upon whether this tax obligation is, within the meaning of the Assignment of Claims Act of 1940, an "indebtedness * * * arising independently of such contract." *Infra*, p. 42. That Act amended the Anti-Assignment Statutes (R.S. 3477 and 3737; *infra*, p. 40.) But in 1951, the

1940 Act was itself amended in significant respects (Act of May 15, 1951, *infra*, pp. 42-45). Consideration of each of these three stages of legislation bearing on the assignment of claims against the United States is necessary in determining the particular question of statutory construction presented in this case.

Under the Anti-Assignment Statute, prior to the 1940 amendment, an assignment such as was made to petitioner was "absolutely null and void" as against the United States. R.S. 3477. Although the assignment might have been enforcible as between the assignor and assignee (*Martin* v. *National Surety Co.*, 300 U.S. 588), it could not operate to the detriment of rights of the United States and any set-off which the United States had against the assignor would have been effective against the assignee (*United States* v. *Munsey Trust Co.*, 332 U.S. 234, 240; *Schmoll* v. *United States*, 105 C. Cls. 415, certiorari denied, 329 U.S. 724).

To assist in the national defense program and to facilitate the financing of public contracts, the 1940 Act validated the assignment of moneys due or to become due under any Government contract if the assignment were made to a bank, trust company, or other financing institution. The Act also made a limited surrender of the Government's broad rights of set-off. It authorized the inclusion, in contracts entered into by the War or Navy Department (but not in contracts of other government departments or agencies), of a provision "that payments to an assignee of any claim arising

under such contract shall not be subject to reduction or set-off"; if the contract did so provide, then "such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States *arising independently of such contract*" (emphasis added).[2] This type of "no set-off" provision was included in the contract entered into between petitioner's assignor and the Navy (R. 34-35).

The 1951 Act, which amended the prior law in several respects, considerably enlarged the scope of the "no set-off" provision by barring the United States from offsetting not only an indebtedness of the assignor "which arises independently of such contract", but also "any liability of the assignor on account of (1) renegotiation * * *, (2) fines, (3) penalties * * *, or (4) taxes, social security contributions; or the withholding or nonwithholding of taxes or social security contributions, *whether arising from or independently of such contract*" (emphasis added). In contrast with other provisions of the 1951 Act which had some retrospective effect, the operation of the enlarged "no set-off" provision was to be prospective only (see *infra*, pp. 44-45).[3]

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[2] Although adopted as a defense measure, the 1940 Act was enacted as permanent legislation. Compare, however, the 1951 Act in which the authority to insert the "no set-off" provisions in contracts was confined to time of war or national emergency (*infra*, p. 44).

[3] This amendment, which was not mentioned in the opinion below, nor called to this Court's attention on petition for certiorari, and is not referred to in petitioner's brief on the merits, nullifies the importance of the issue presented by this case. The issue will not arise under the 1951 Act since the express

B. The words "independently of [the] contract" in the 1940 Act should be accorded their plain and usual meaning, *viz.*, not dependent or contingent or conditioned upon, completely disassociated from, the contract. An indebtedness which arises independently of the contract, in the words of the sponsor of the 1940 legislation, is one which has "no relationship whatever to the contract." The legislative history shows that Congress intended to save to the Government the right to set off against the assignee any indebtedness of the contractor arising as a consequence of the contract. Here, the assignor's tax indebtedness was contingent upon and arose as an inevitable consequence of performance of the contract. Since the Internal Revenue Code required the contractor, as an employer, to withhold part of the gross wages of its employees engaged in performing the contract, the tax indebtedness was an indivisible part of the obligation to pay wages and could have no existence apart from the payment of wages under the contract.

Under the 1940 Act, where the contractor's indebtedness is not independent of the contract, the assignee has no greater rights than the contractor whose claim he asserts. The general law of as-

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language of that Act settles the matter. It is unlikely that a decision by this Court is necessary for the future administration of the 1940 Act; there is no conflict of decisions involved; petitioner has not pointed to any other pending case raising the issue and our own search and inquiry reveal none. It is unfortunate that the existence of the 1951 Act was not made known to the Court, at the petition stage, either by petitioner or the Government, and we regret the Government's failure to call attention to that Act in its brief in opposition.

signments permits an obligor to set off against the assignee claims against the assignor which arise out of the assigned obligation. The construction contended for by the Government in this case would simply effect the same result, and, in any event, the general set-off statutes give the United States the largest powers of set-off. The Government is not, as petitioner contends, merely a general creditor of the assignor, but "the best secured of creditors" since it retains the money necessary to create a fund to pay other creditors. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 240. As against an assignee standing in the shoes of the contractor, the claims of the United States must prevail.

If there be ambiguity in the language of the 1940 statute, it should be resolved in favor of the United States under the admonition to avoid a construction leading to loss to the public treasury. And since the Assignment of Claims Act of 1940 is in derogation of the Government's broad rights of set-off and of the absolute protection formerly given under the Anti-Assignment Statutes, there is no occasion for any broader reading than is demanded by the precise aim of Congress in relaxing the old requirements. The basic purpose of the 1940 Act was not to favor the assignee bank, but to assist the government contractor in obtaining financing and, at the same time, to protect the Government's interests adequately. To permit set-off of the instant tax claims would not defeat the purposes of the 1940 Act, but, rather, would properly accom-

modate the two goals of protecting the Government and of easing the contractor's obtaining of credit.

C. Nor is there anything in the Internal Revenue Code to bar the Government's claim. The Code required the contractor to withhold taxes "as and when" wages were paid and immediately created liability in the contractor for the amounts deducted or which should have been deducted. Such liability is enforcible by an action for debt. Section 3661 of the Code, providing that when a person withholds taxes from another such amount shall be held in trust for the United States, does not, as petitioner contends, relegate the United States to trust remedies exclusively, but merely provides remedies which are alternative to and in addition to its other methods of collection. Hence, the Government's claim here is not exclusively for "embezzlement" of trust moneys, but may be rested on the debt which arose the moment wages were paid.

I

A Contractor's Tax Indebtedness Arising from Performance of the Contract May Be Set Off by the United States against the Contractor's Assignee.

A. *An Indebtedness which Is a Necessary Consequence of Performance of a Contract Is Not Independent of that Contract Within the Meaning of the Assignment of Claims Act of 1940.*

The only indebtedness of the assignor which the Government may not set off against an assignee under the 1940 Act is one "arising independently of [the] contract." These are not words of art,

but are common words of popular usage and, in the absence of some dominant contrary reason, they should be accorded their plain and usual meaning. *Old Colony Co. v. Comm'r*, 301 U.S. 379, 383; *United States v. Amer. Trucking Ass'ns*, 310 U.S. 534, 543; *Browder v. United States*, 312 U.S. 335, 338. The critical word is "independently." The term "independent" means "not dependent"; "not contingent or conditioned"; "separate; exclusive; irrespective"; "uncontrolled."[4] To be "independent" requires that there be "complete disassociation" (cf. *Amer. Fire & Cas. Co. v. Finn*, 341 U.S. 6, 12; *Snow v. Powell*, 189 F. 2d 172, 174 (C.A. 10)). An indebtedness which is independent of the contract, Senator Barkley who sponsored the 1940 legislation indicated, is one which has "no relationship whatever to the contract" (86 Cong. Rec. 12803). To be independent of the contract, as was aptly stated by the court below, the indebtedness must arise "irrespective of, exclusive of, and separate from the contract, and must have no direct relation with such contract" (R. 78). Anything less would not conform with the ordinary and natural meaning of the word "independent."

Measured by this standard, it cannot be said that the contractor's tax indebtedness arose "independently" of the contract. The agreement contemplated that the ship repairs would be performed by employees hired by the contractor. It included various provisions controlling working conditions

[4] Webster's *New International Dictionary, Unabridged* (2d Ed., 1934), p. 1262; and see Black's *Law Dictionary* (3rd Ed., 1933), p. 950.

(*e.g.*, R. 36, 39-40), requiring reports showing the items of labor, the hours worked, the wages paid, etc. (R. 19-20, 25), and it provided also that the assignor be compensated partly on the basis of Payable Hours of Direct Labor, as defined in the contract (R. 15-16). There could be no performance without the services of the assignor's employees, and as soon as performance was undertaken and wages were paid the tax indebtedness necessarily arose. This follows from the provisions of the Internal Revenue Code (I.R.C. 1401, 1622) which required the contractor-employer to deduct and withhold stated percentages of the gross amounts of wages paid to its employees (R. 73). The moment the wages were paid, the assignor became liable directly to the Government (I.R.C. 1623), in the place of its employees (I.R.C. 35), to the extent of the taxes which were or should have been withheld (*United States* v. *New York*, 315 U.S. 510, 516). The contract could not have been performed without giving rise to that tax obligation; hence, the tax indebtedness was not "completely disassociated" from the contract. On the contrary, its existence was contingent upon and an inevitable consequence of performance of the contract. An indebtedness which necessarily and inescapably must be incurred in the performance of a contract does not arise "independently" of the contract.

Here, the relationship of the tax obligation to the contract was even more than a "but for" relationship. Taxes arising during the course of performance of the contract were considered by the

Navy in establishing the job rates and had a direct connection with the costs of the contract (R. 63-64, 67).[5] Just as wages were a cost of the contract, so was the tax indebtedness, because, as an integral part of the contractor's obligation to pay wages, there was a concurrent obligation to withhold part of those wages and pay that part to the Government. Stated another way, a portion of the wages which accrued in performing the contract had to be paid directly to the Government.[6] The failure to make that payment is the reason the contract was terminated (R. 73, 64). It is not necessary to

[5] The close relationship between the contract price and the tax liabilities incurred by a contractor during performance is reflected in express provisions in some government contracts calling for an adjustment in the price, following the imposition or modification of taxes. See *United States* v. *Kansas Flour Corp.*, 314 U.S. 212; *United States* v. *Standard Pipe Co.*, 323 U.S. 106; compare, *United States* v. *Glenn L. Martin Co.*, 308 U.S. 62.

[6] For the purposes of this case, it makes no difference whether the moneys withheld be regarded as part of the gross wages earned by the employees or as a tax upon the employer. Compare *U. S. Fidelity & Guaranty Co.* v. *United States*, 201 F. 2d 118 (C.A. 10), with *United States* v. *Swedlow Engineering Co.*, 100 F. Supp. 796, 798 (S.D. Cal.), pending on appeal *sub nom. Firemen's Fund Indemnity Co.* v. *United States* (C.A. 9), and *National Surety Corp.* v. *Barth*, 89 A. 2d 104, 109 (N.J. Super.). In these cases, following default by a contractor under a non-government contract, the United States, claiming employee wage withholding taxes, was competing with the contractor's surety, claiming subrogation, for funds owed under the contract. The surety, which has agreed to be liable for all wage claims, is clearly subordinate to the United States if the sums withheld are wages. Whether representing wages or taxes—a question not raised or decided in *United States* v. *New York*, 315 U.S. 510—the indebtedness in the instant case was contingent upon performance of the contract and therefore was not independent of the contract. But if the amounts withheld are deemed wages, then the claim of the United States may be based upon an assignment by operation of law of the employees' rights to that part of their gross wages which was withheld. See *infra*, fn. 41. This again emphasizes the close relationship between the assignor's indebtedness and the contract.

show that this indebtedness was created by the terms of the contract, rather than by the revenue laws, to escape the set-off bar of the 1940 Act (compare Pet. Br. pp. 12-13); it suffices if the relationship between that indebtedness and the contract is such as to preclude their being independent of each other. There is no such independence if the tax indebtedness could not exist apart from the contract and if, in fact, the obligation arose as a natural and inevitable incident of performance of the contract.

Petitioner suggests (Br., p. 9) that permissible set-offs should be limited to those arising from the Government's actions as the second contracting party, and that other government claims, such as demands for taxes, should be excluded. But there is no warrant in the language or purposes of the 1940 Act for such a restriction. To define the excluded class, the Act uses the general term "independently of such contract" rather than a term such as "claims not under the contract" or "claims other than those for breach of the contract", which would limit the United States to its demands as a contracting party.[7] And the sponsor of the Act, Senator Barkley, said on the floor that the exclusion was directed to "an indebtedness which the contractor may owe the Government on account of some other contract or some other situation. * * *

[7] Of course, the United States acts in a governmental capacity both when it enters into a contract and when it collects taxes. *Federal Land Bank* v. *Bismarck Co.*, 314 U.S. 95, 102; *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 383-4; *Pittman* v. *Home Owners' Loan Corp.*, 308 U.S. 21, 32; *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466, 477.

a claim against the contractor on account of something else which had no relationship whatever to the contract and the defense program" (86 Cong. Rec. 12803).

Nor can petitioner contend that when it took the assignment it was unaware of a possible tax claim incident to performance under the contract. Petitioner was as aware as its assignor, if not through actual knowledge then certainly constructively,[8a] that wages would have to be paid for labor to perform the contract, that the contractor was required by law to withhold part of such wages, and that until that portion was paid to the Collector of Internal Revenue the contractor would be indebted to the Government. This was merely one of the liabilities, along with others such as for the cost of materials, rents, equipment, etc., which would be incurred in performing the contract.[8b] In considering the risks involved in making the loan, petitioner should reasonably have included the matter of taxes because the tax obligation was an indispensible ingredient of the obligation to pay wages and wage-payments were, of course, an essential element in the performance of the contract.

[8a] Cf. *Schmoll* v. *United States*, 105 C. Cls. 415, 455, certiorari denied, 329 U.S. 724; *Royal Indemnity Co.* v. *United States*, 111 C. Cls. 736, 746-7, 93 F. Supp. 891, 894.

[8b] Government guarantees of loans were available if a bank could not, by applying normal credit standards, extend a loan to a contractor. See 50 U.S.C. App. 1107 as implemented by Executive Order No. 9112, March 26, 1942, 7 F.R. 2367; Federal Reserve Board Regulation V, 7 F.R. 2773, revised, 9 F.R. 11148, 12 C.F.R. 223.1-5 (1944 Supp.). See also American Bankers Association, Bank Management Publication No. 101, *War Loans* (1943).

B. The 1940 Act Should Be Construed to Protect the United States.

1. *The rights of the United States under the general anti-assignment and offset legislation.*—From its earliest years, the Government has been concerned with the need of maintaining close supervision over the collection and expenditures of public moneys and with providing a full measure of protection in the ascertainment and allowance of claims against it.[8c] The Anti-Assignment Statutes[9] and the laws which give the United States broad rights of offset and counterclaim[10] constitute an integrated body of legislation intended to enforce this purpose of protecting the United States in its fiscal operations and management.

a. As for the Anti-Assignment Statutes, the Court has time and again emphasized that protective purpose.[11] Before it was amended by the 1940 Act, R.S. 3477 declared that all transfers and assignments of claims upon the United States and all powers of attorney for receiving payment "shall be

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[8c] For a review of some of the legislation, see *Lambert Lumber Co.* v. *Jones Engineering & Construction Co.*, 47 F. 2d 74, 79-81 (C.A. 8); 13 Op. Atty. Gen. 482; Nichols, *Assignment of Claims Act of 1940*, 12 U. of Pitt. L. Rev. 538, 541-546 (1951).

[9] R.S. 3477, 31 U.S.C. (1934 ed.) 203 (*infra*, p. 40); R.S. 3737, 41 U.S.C. (1934 ed.) 15.

[10] 28 U.S.C. 1346(c), 1503 (*infra*, p. 45), 2508; 31 U.S.C. 71 (*infra*, p. 45), 227.

[11] *E.g.*, *Hobbs* v. *McLean*, 117 U.S. 567, 576; *Nutt* v. *Knut*, 200 U.S. 12, 20; *McGowan* v. *Parish*, 237 U.S. 285, 294-295; *Martin* v. *National Surety Co.*, 300 U.S. 588, 594-595; *United States* v. *Shannon*, 342 U.S. 288, 291-293.

absolutely null and void" unless executed after the allowance of the claim, after ascertainment of the amount due, and after the issuance of a warrant for the payment of the claim.[12] Not designed as a means of regulating the rights *inter se* of the parties to the assignment (*McKenzie* v. *Irving Trust Co.*, 323 U.S. 365, 369; *Martin* v. *National Surety Co.*, 300 U.S. 588, 595), the restrictions upon assignment are intended to save to the United States defenses to claims by an assignor which might not be applicable to an assignee, to prevent possible multiple payments of claims, to preclude persons from peddling or speculating in such claims, to avoid the necessity of investigating numerous alleged assignments, and to enable the Government to deal only with the original claimant.[13] *United States* v. *Shannon*, 342 U.S. 288, 291-293; *United States* v. *Aetna Surety Co.*, 338 U.S. 366, 371.

Protection to the Government being the predominant and controlling consideration, the provisions of the anti-assignment legislation have been rigidly adhered to and strictly applied where the rights of the United States are at stake, even in the situation, as in *United States* v. *Shannon*, *supra*, where all possible claimants are before the court. Only when the assignment is of a type which would not

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[12] The transfer of the contract, or any interest therein, was forbidden by R.S. 3737, 41 U.S.C. (1934 Ed.) 15 which further provided that "any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned."

[13] See also, fn. 22, *infra*.

tend to frustrate the purposes of the law has this strictness been relaxed.[14]

b. The offset laws are equally potent in their protective purpose and effect. They express, as Judge Learned Hand said, "the general policy * * * that claims against the United States are always to be subject to set-off." *Ozanic* v. *United States*, 188 F. 2d 228, 231 (C.A. 2); cf. *Cherry Cotton Mills, Inc.* v. *United States*, 327 U.S. 536, 539-540. If this suit had been brought by the contractor-employer, there is no question but that the Government could have set off the moneys owed under the contract in extinguishment of the contractor's tax liability. The offset would have been proper without regard to whether the tax obligation arose out of or was independent of the contract upon which the claimant sued. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239; *United States* v. *American Surety Co.*, 158 F. 2d 12 (C.A. 5); see, *Wooton* v. *United States*, 114 C. Cls. 608, 611, 86 F. Supp. 143, 144, certiorari denied, 339 U.S. 903.[15] For, as this Court has often asserted, the Govern-

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[14] *E.g.*, the restrictions have been held inapplicable to assignments by operation of law (*United States* v. *Aetna Surety Co.*, *supra*) and to those voluntary assignments which are closely akin to the involuntary, such as a transfer by will (*Erwin* v. *United States*, 97 U.S. 392, 397) or a general assignment for the benefit of creditors (*Goodman* v. *Niblack*, 102 U.S. 556, 560-561). Also, since the United States is the only party to be protected, it may waive or disregard the anti-assignment provisions and pay the assignee (*Bailey* v. *United States*, 109 U.S. 432).

[15] Tax claims, being quasi-contractual in nature (*Milwaukee County* v. *White Co.*, 296 U.S. 268, 271) and recoverable "as for a debt in every case where not prohibited by statute" (*Billings* v. *United States*, 232 U.S. 261, 288), are clearly within the coverage of the offset statutes. *United States* v. *American*

ment has the same right which belongs to every creditor "to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." *United States* v. *Munsey Trust Co., supra; McKnight* v. *United States,* 98 U.S. 179, 186; *Gratiot* v. *United States,* 15 Pet. 336, 370. The authority of the Comptroller General and the jurisdiction of the Court of Claims "to strike a balance between the debts and credits of the government" in such a situation is not open to question. *United States* v. *Munsey Trust Co., supra,* 332 U.S. at 240.

Since the 1940 Act retains to the United States the right to set off against the assignee whatever claims it has against the assignor—except those which arise independently of the contract—it is indisputable that these rules apply if the assignor's debt is not independent of the contract. The situation is then the same as if the assignor itself had brought the suit; the assignee simply stands in the shoes of the assignor. Cf. *Royal Indemnity Co.* v. *United States,* 117 C. Cls. 736, 748, 93 F. Supp. 891, 895; *Hardin County Sav. Bank* v. *United States,* 106 C. Cls. 577, 599, 65 F. Supp. 1017, 1022; *Modern Industrial Bank* v. *United States,* 101 C. Cls. 808, 820. It makes no difference that the United States acquired its claim after it received notice of the assignment to petitioner. Even un-

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Surety Co., 158 F. 2d 12 (C.A. 5); *Standard Acc. Ins. Co.* v. *United States*, 119 C. Cls. 749, 97 F. Supp. 829; *Rhode Island Discount Company* v. *United States*, 118 C. Cls. 262, 286; *Schmoll* v. *United States*, 105 C. Cls. 415, 455, certiorari denied, 329 U.S. 724; *Boughton* v. *United States*, 13 C. Cls. 284; *Roman et al.* v. *United States*, 11 C. Cls. 761.

der the private law of assignments, a claim acquired after notice of the assignment may be set off against the assignee if that claim stems from the assigned contract. 2 Williston, *Contracts* (Rev. Ed.), pp. 1253-1254. The Government has that right, but it can also rely on the general provisions of the offset legislation. Once the "no offset" clause of the 1940 Act is out of the way,[16] the Government may look to the broad scope of the general set-off statutes for the authority and jurisdiction to effectuate the set-off. Cf. *Cherry Cotton Mills, Inc.* v. *United States, supra*; *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239-240. As the Court put it in the *Munsey Trust* case, the United States is in these circumstances "the best secured of creditors." Its security is its "justified refusal to pay what [it] owes until [it] is paid what is due [it]" (332 U.S. at 240). "Insofar as the suitor in the Court of Claims asserted the contractor's title to the sum in dispute, that court was under statutory duty to recognize the undisputed claim for damages of the United States" (*ibid.*).[17]

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[16] Where the Government's claim is independent of the contract, the assignee may obtain greater rights under the 1940 Act than he would have under the general law of assignments. For the general rule is that an assignee of a non-negotiable chose in action, though he buys it for value and in good faith, takes it subject to all defenses which the obligor may have had against the assignor, including not only those defenses which relate to the assigned obligation itself, but also subject to rights of set-off, or counterclaim arising out of separate matters which the obligor might have asserted against his original creditor, the assignor." 2 Williston, *Contracts* (Rev. Ed.), pp. 1244-1245.

[17] Cases (cited at Pet. Br. pp. 14-15) in which the United States did not assert a claim of its own but was merely a

c. In determining whether the tax indebtedness involved here is within or without the "no set-off" clause of the 1940 Act, it is proper to read that Act's language in its historic setting of a consistent legislative purpose to provide protection to the Government's fiscal operations and of a continuing body of decisional law seeking to achieve that end. On the one hand, before 1940 all assignments were "absolutely null and void" as against the United States (R.S. 3477); on the other, "all claims and demands whatever by the Government" could be

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stakeholder, are inapposite. There, the question usually is one of priority, as between the contractor's surety and his assignee-bank, to funds owed by the United States. The surety prevailed before the 1940 Act. *Prairie State Bank* v. *United States*, 164 U.S. 227. The surety has also prevailed where the bank claimed under an assignment authorized by the 1940 Act. *E.g.*, *Royal Indemnity Co.* v. *United States*, 117 C. Cls. 736, 93 F. Supp. 891; but contrast, *Coconut Grove Exchange Bank* v. *New Amsterdam Cas. Co.*, 149 F. 2d 73 (C.A. 5). The rights of the surety to the contract funds attach when the contract of suretyship is entered into (*Prairie State Bank, supra*) and are fortified by rights of subrogation; *i.e.*, the surety may not only assert the contractor's rights (under an assignment prior in time to the bank's), but also may resort to the remedies and securities of the one whose claim it pays. Cf. *American Surety Co.* v. *Bethlehem Bank*, 314 U.S. 314, 317; and see, *In re Cummins Const. Corporation*, 81 F. Supp. 193 (D. Md.). The assignee, on the other hand, obtains no greater rights than the contractor possessed, and the contractor's rights are "subordinate to those of the *United States* and the sureties" (*Prairie State Bank, supra*, 164 U.S. at 240) (emphasis added). Compare, *U.S. Fidelity & Guaranty Co.* v. *Triborough Bridge Authority*, 297 N.Y. 31, 74 N.E. 2d 226 (holding the surety's rights to contract funds, owed by a third party to the defaulting contractor, superior to claims of the United States for the contractor's income taxes). When, however, the United States, as in this case, is asserting a claim to the funds in its own possession, its right of set-off, under the *Munsey Trust* decision, is superior both to the rights of the surety and of the assignee. See also, *Standard Accident Ins. Co.* v. *United States*, 119 C. Cls. 749, 97 F. Supp. 829 (tax set off by United States permitted against surety).

set off (31 U.S.C. 71). Since the 1940 Act is in derogation of the absolute protection formerly accorded the United States by the Anti-Assignment Statutes, and since it deprives the Government of the full offset contemplated by the set-off statutes, the "no set-off" clause should not be given any broader interpretation than is required by the needs which impelled Congress to act. Where there is doubt as to the meaning of a statute operating as a relinquishment of a public right or interest, that construction is to be adopted which works the least harm to the state and also accords with the legislative purpose. *Northern Pacific R. Co.* v. *United States*, 330 U.S. 248, 257; *United States* v. *Powers*, 307 U.S. 214, 217; *Blair* v. *Chicago*, 201 U.S. 400, 471-473; cf. *Posadas* v. *National City Bank*, 296 U.S. 497, 503-505. Furthermore, a construction which would lead to a loss to the public treasury should not be adopted unless the intention of Congress is expressed in clear and explicit terms. *United States* v. *Herron*, 20 Wall. 251, 263-264; *United States* v. *Bank of North Carolina*, 6 Pet. 29, 35; *Price* v. *United States*, 269 U.S. 492, 500.

2. *Legislative history and purpose of the 1940 Act*—The bill[18] which later became the Assignment of Claims Act of 1940 was drafted and proposed by officials of the Federal Reserve System.[19]

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[18] The same bill was introduced in both houses of Congress. Senator Barkley sponsored the measure in the Senate (S. 4340, 76th Cong., 3rd Sess.) and Representative Sumners in the House (H.R. 10464, 76th Cong., 3rd Sess.).

[19] See Hearing before the Senate Committee on Banking and Currency on S. 4340, 76th Cong., 3rd Sess., p. 2.

Its object was to facilitate the financing of public contracts and particularly to help small businessmen who did not have sufficient working capital to undertake large defense orders or sufficient assets to pledge as security for private loans. Such financing, it was believed, would be obtained more easily if the payments due or to become due from government contracts could be assigned as security to the lender.[20] It is significant, however, that

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[20] *Ibid.*; see also, 86 Cong. Rec. 12556-12560; 13121-13122. Explaining the purpose of the bill, the Board of Governors of the Federal Reserve System called attention to the strict wording of R.S. 3737 and 3477 and the strict interpretation given in *National Bank of Commerce* v. *Downie*, 218 U.S. 345 (holding that assignments to banks as security for loans to finance government contract work were "null and void" as against the contractor's trustee in bankruptcy); and said (Hearing, *supra*, fn. 19, at p. 3):

> * * * As a consequence, banks and other lending agencies which might otherwise be willing to extend credit to finance the performance of contracts with the Government are unable to rely upon assignments of amounts payable under such contracts as security, because they would find themselves in the position of general creditors of the contractors in the case of bankruptcy even though the funds which they advanced may have made the fulfillment of the contracts possible.
>
> There are many manufacturers and other businesses, particularly the smaller ones, which may be deterred from bidding on contracts arising out of the program for national defense because they have inadequate amounts of working capital and may encounter difficulties in financing the performance of such contracts. If such businesses could offer security in the form of assignments of claims against the Government growing out of such contracts, they would in many instances be able to obtain the necessary credit from their own local banks and other financing institutions, which have large amounts of idle funds awaiting employment. In many instances such credit could be obtained more simply and quickly from local institutions than from the lending agencies of the Government, whose commitments usually have to be passed upon in Washington.

the bill, as introduced and as recommended by the committees of both houses, did not include any limitation upon the Government's right of set-off. This indicates that at the outset the bill was not intended to give an assignee bank priority over the Government's claims; rather, its proponents believed that it would suffice if the lender were assured priority over other general creditors, particularly in the event of insolvency.[21]

The provision barring the Government from setting off an indebtedness of the assignor arising independently of the contract was proposed as an amendment by Senator Barkley on the floor. 86 Cong. Rec. 12803. As noted above (pp. 14-15), he explained the words as meaning "an indebtedness which the contractor may owe the Government on account of some other contract or some other situation. * * * a claim against the contractor on account of something else which had no relationship whatever to the contract and the defense program." *(Ibid.)* This, we submit, marks the meaning of the

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In recommending the bill favorably, the committees of both the House and Senate adopted this statement *verbatim* as their explanation of the bill. H. Rep. No. 2925, 76th Cong., 3rd Sess., p. 2; S. Rep. No. 2136, 76th Cong., 3rd Sess., p. 2.

[21] See fn. 20, *supra*. Petitioner (Br. p. 7) points to Senator Barkley's remark that the purpose of the bill is to permit the contract to be assigned as security, "then when the work is completed and the Government is ready to pay the contractor, naturally the bank has a first claim on it" (*Hearing*, *supra*, fn. 19, at p. 2). But it is obvious that Senator Barkley was not referring to any priority of the assignee over the Government, but, instead, to the assignee's priority over other claimants. If the Government were "ready to pay", in the Senator's words, it would not be asserting any claim of its own. Besides, the restriction on the Government's right of set-off was not in the bill nor had it been proposed at the time the remark was made. *Ibid.*, p. 1.

disputed clause: the indebtedness is independent of the contract if it has "no relationship whatever" to the contract". Both the Comptroller General and the court below have consistently applied this interpretation of the provision. *Modern Industrial Bank* v. *United States*, 101 C. Cls. 808, 820-821; *Rhode Island Discount Co.* v. *United States*, 118 C. Cls. 262, 286; 30 Comp. Gen. 98; Comp. Gen. Dec. B-72929 (May 18, 1950) (R. 62-67).

While the 1940 Act relaxes the restrictions upon assignments within a narrow area, it nevertheless reflects a recognition and continuation of, rather than a basic departure from, the long established policy protecting the interests of the United States. Its prime purpose was not, as petitioner contends, to protect the assignee bank, but was to aid the contractor in obtaining financing and still provide adequate protection to the Government. See 86 Cong. Rec. 12559, and *supra*, pp. 22-24. This purpose was accomplished by recognizing the validity of a contractor's assignment to a bank (thus nullifying the result reached in *National Bank of Commerce* v. *Downie*, *supra*, fn. 20) and, at the same time, by surrounding that assignment with conditions safeguarding the interests of the United States. Thus, the validity of assignments was recognized only when made to a bank, trust company, or other financing institution, including any Federal lending agency.[22] Even then, the assignment

[22] The Congressional debates reveal an additional reason for restrictions upon assignments; *viz.*, assignment of claims under a government contract would result in disclosure of the contents of the contract to the assignee and persons other than the

was conditioned upon the Government's consent since the contract could forbid it; and, unless permitted by the contract, the assignment was required to cover all unpaid amounts due under the contract, could be made to only one party, and the claim was not subject to further assignment. Notice had to be filed with the General Accounting Office, the contracting officer or the head of his agency, the disbursing officer, and the sureties, if any.

These provisions both reveal and achieve the two purposes of the Act—aiding the contractor and simultaneously protecting the Government. Hence, there is no merit to petitioner's argument that the general purpose of the 1940 Act will be defeated if tax claims are excluded from the "no set-off" clause, for the "no set-off" provision itself is not a *sine qua non* of achieving that general purpose.[23] The

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contractor, and, since such contracts often deal with matters relating to the national defense, uncontrolled disclosure might be detrimental to the security of the nation. 86 Cong. Rec. 12556-7, 13135. For that reason, unlimited assignments to lending institutions were not permitted; instead, the Act prohibited the assignment of claims under a contract entered into after the date of approval of the Act if the contract forbids such assignment, and, as to contracts entered into prior to that date, prohibited the assignment unless consented to by the head of the department or agency concerned (31 U.S.C. 203; 41 U.S.C. 15; *infra*, pp. 40-42).

[23] A provision very similar to the Assignment of Claims Act of 1940, but without the "no set-off" clause, was included in Sec. 207 of the National Industrial Recovery Act of June 16, 1933, 48 Stat. 205, 40 U.S.C., 407 (1940 Ed.). As stated in that section, its purpose was to provide financial assistance to persons under contract with the United States in connection with the public works program. The section expired June 30, 1943 under the terms of the Act of June 27, 1942, 56 Stat. 410. No cases construing that section have been found.

clause had only a limited application within a larger area of newly permissible assignments—it applied only to certain contracts of the War and Navy Departments—and was certainly not central to the design or purpose of the Act. It is one thing to enact a general validation of assignments to banks to facilitate the financing of contractors. It is another thing to insert a "no set-off" clause which limits the Government's rights as to some of those assignments. And it is still another thing to enlarge that "no set-off" clause so as to bar the offset of tax debts arising out of the performance of the contract. Enlargement of the bar might, it is true, give additional security to the private lender. But a refusal to enlarge the bar would be more consistent with the protective policy of legislation conferring broad set-off powers upon the Government. As between the two, the protective interest of the Government should prevail, especially since the general purpose of the 1940 Act would not be frustrated by the narrower construction of the "no set-off" clause.

3. *The Act of May 15, 1951, and its legislative history*—The subsequent action of Congress throws light on our contention that the offset of tax claims arising as an incident to performance of the contract is not barred by the 1940 Act.[24] The problem

[24] It is a well settled principle of statutory construction that "subsequent legislation may be considered to assist in the interpretation of prior legislation upon the same subject." *Tiger* v. *Western Investment Co.*, 221 U.S. 286, 309; *Great Northern Ry. Co.* v. *United States*, 315 U.S. 262, 277; cf. *United States* v. *Hutcheson*, 312 U.S. 219; *Brown* v. *Duchesne*, 19 How. 183, 194.

of financing defense contractors received renewed consideration under the impetus of the stepped-up military program stemming from the Korean conflict. Banking institutions indicated a reluctance to make loans on the basis of an assignment of claims under the borrower's government contracts because of the manner in which the Comptroller General had interpreted the 1940 Act.[25] Two decisions disturbed the banks. In one, the General Accounting Office ruled that payments made to an assignee bank pursuant to the Assignment of Claims Act of 1940 may subsequently be recovered by the Government on account of an overpayment due to price revision.[26] In the second decision—in the instant case—it was ruled that a tax indebtedness which is incident to performance of the contract is not independent of the contract and therefore may be set off against the assignee bank.[27]

To meet this problem, the Board of Governors of the Federal Reserve System recommended changes in the 1940 Act.[28] By the Act of May 15, 1951, 65 Stat. 41 (31 U.S.C., Supp. V, 203, 41 *id.* 15) (*infra*, pp. 42-45), Congress amended the law so as to provide (in so far as relevant here), first, that an assignee bank shall not be liable to make repayment to the United States of any amounts received

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[25] S. Rep. No. 217, 82nd Cong., 1st Sess., p. 2; H. Rep. No. 376, 82nd Cong., 1st Sess, p. 1.

[26] Comp. Gen. Dec. B-84138 (May 17, 1949). But compare 24 Comp. Gen. 603.

[27] R. 62-67; Comp. Gen. Dec. B-72929 (May 18, 1950). See also, 20 Comp. Gen. 424; 30 Comp. Gen. 98.

[28] H. Rep. No. 376, 82nd Cong., 1st Sess., p. 2.

under an assignment since and after July 1, 1950, and, second, that payments to an assignee under an existing contract containing a "no set-off" clause

> shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States * * * which arises independently of such contract, or *hereafter* for any liability of the assignor on account of (1) renegotiation * * *, (2) fines, (3) penalties * * * or (4), *taxes,* social-security contributions, or the withholding or nonwitholding of taxes or social security contributions, *whether arising from or independently of such contract.* Except as herein otherwise provided, nothing in this Act, as amended, shall be deemed to affect or impair rights or obligations heretofore accrued [emphasis added].[29]

It is evident from the language as well as from the legislative history of the 1951 amendment that it was intended as a modification rather than a clarification of the 1940 Act. Thus, the provision barring the Government from recapturing funds already received by an assignee-bank was made retroactive but only back to July 1, 1950, which is the approximate date of the outbreak of the Korean conflict. Had it been simply a clarifying amendment, there would have been no occasion for a cut-off date. And, in sharp contrast, there is no similar retroactivity provided for set-offs of fines, penalties and taxes owed by the assignor. On the contrary, the amplified "no set-off" provi-

[29] See fn. 3, *supra*, pp. 7-8.

sion was only to be effective "hereafter" (*supra*, p. 28).[30]

In this connection, it also seems significant that, despite the sponsors' knowledge of the Comptroller General's ruling in the instant case, the bill, as introduced in both houses of Congress, did not include in its broadened "no set-off" clause any reference to tax claims.[31] The limitation on

[30] Explaining the broadened "no set-off" clause and the purpose of the last sentence of the amending law, (*supra*, p. 28), the House Committee on the Judiciary said (H. Rep. No. 376, 82nd Cong., 1st Sess., p. 4):

> * * * Any "no set-off" clause now contained in existing contracts of the Department of Defense would automatically be enlarged upon the enactment of H.R. 3692 to conform to the amplified clause without the necessity of amending such contracts, and the enlarged clause would be applicable to all payments to be made under such contracts after the date of enactment.
>
> Finally, the bill states specifically that except as otherwise therein provided, it shall not affect or impair rights or obligations accrued prior to the date of its enactment. This is to make it clear that neither the provision relieving assignees from liability to make restitution of amounts received nor the amplified "no set-off" provision contained in the bill implies either approval or disapproval of the construction placed upon the existing provisions of the Assignment of Claims Act by the Comptroller General or by assignees.

[31] Identical bills were introduced in the Senate (S. 998) and in the House (H.R. 2947), 82nd Cong., 1st Sess. The Senate Committee on Banking and Currency, which reported the bill favorably with certain amendments, made note of the Comptroller General's ruling in its report but did not make any recommendation to amend the bill so as to modify that ruling for the future. S. Rep. No. 217, 82nd Cong., 1st Sess., p. 2. A provision prohibiting set-off on account of the assignor's tax liability, even though such liability arose from the assigned contract, was in the draft of the bill prepared by the Board of Governors of the Federal Reserve System. This provision was deleted by the Bureau of the Budget before the bill was introduced in Congress. Hearings before Subcommittee No. 4 of the Committee on the Judiciary, House of Representatives, 82nd Cong., 1st Sess., on H.R. 2947, p. 64.

the Government's right to set-off tax claims flowing from the contract came into the bill after extensive hearings by the Committee on the Judiciary of the House, including one addressed specifically to that question.[32] During the course of those hearings, a committee of representatives of the American Bankers Association, other financing institutions, and the General Accounting Office, met with members of the Committee on the Judiciary and revised the proposed bill.[33] The clause as to taxes (*supra*, p. 28) appeared in the revised bill drafted as a result of these consultations. That the new "no set-off" clause was intended to affect only payments to become due after enactment of the bill is patent from the committee's Explanatory Statement in which it was said that the new "no set-off" clause "would affect only payments to be made thereafter. Contracts of the Defense Department containing the existing no set-off clause would not require amendment to come within the new clause, although the new clause would be applicable only to payments to be made after enactment of the amendment." [34]

That the provision as to taxes was intended to modify, and not merely to clarify, the 1940 law is also evident from this Explanatory Statement. The tax provision, the committee stated, was in-

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[32] Hearings, etc., *supra*, fn. 31, at p. 61 *et seq.*

[33] *Ibid.*, at pp. 61-64. The revised bill was reintroduced as H.R. 3692 and was reported favorably. See fn. 30, *supra*. It was adopted on the floor of the Senate as an amendment to S. 998 (97 Cong. Rec. 4350) and later became the Act of May 15, 1951 (*infra*, pp. 42-45).

[34] Hearings, etc., *supra*, fn. 31, at p. 63.

serted in the revised draft at the request of the financing institutions because, "Without this language * * * the clause would not prohibit set-off on account of any tax liability of the contractor which might not arise independently of the contract * * *."[35]

II

The Trust Fund Provisions of the Internal Revenue Code Do Not Preclude the Set-off.

Petitioner contends (Br. 13) that if a tax indebtedness arising from performance of a contract is dependent on the contract, within the meaning of the 1940 Act, and is therefore subject to set-off, the tax claim in this suit lost its dependent character once the taxes were in fact withheld. It is said that this follows from the requirement of the Internal Revenue Code that whenever any person collects or withholds any tax from another person, the amount so collected or withheld "shall be held to be a special fund in trust for the United States" (I.R.C. 3661, *infra*, pp. 46-47). The theory is that, once the taxes were withheld, the assignor was no longer "indebted" to the United States, but simply a trustee owing the duty to turn over the trust *res* to the United States; and in these circumstances the United States would have no cause of action at all for a general indebtedness, but its "sole remedy" would be in equity to compel the trustee to turn over to it the trust *res*.[36]

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[35] *Ibid*, at p. 64.

[36] Petitioner also contends that the assignor's indebtedness

The argument is without merit. It ignores the basic factor that the indebtedness was, at the outset and at all times thereafter, an indebtedness of the assignor in its personal capacity, that the indebtedness arose as soon as wages were paid, and that the indebtedness was never discharged. The contention also departs from long established principles favoring construction of revenue statutes so as to give the United States cumulative remedies instead of depriving it of aids in enforcing collection of taxes, and disregards the legislative history of I.R.C. 3661 which clearly shows that its purpose was to accord additional remedies. The argument likewise violates the basic precept of trust law that the beneficiary of the trust may sue the defaulting trustee in an action for debt as well as for breach of trust. In sum, if petitioner's argument were adopted, the United States would be in a worse position where the taxes are withheld than where they are not.

During the course of performing the contract, the assignor deducted and withheld from the salaries and wages of its employees $11,462.91, representing federal unemployment taxes, and $453,469.55, representing withholding of income taxes

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in this case stems, not from the contract, but from criminal embezzlement of the trust funds. Although petitioner makes frequent reference to "embezzlement," the record (R. 70, 74, 76) reveals that the partners of the assignor company were found guilty of "wilful attempt to evade and defeat the payment of the * * * withheld taxes" under I.R.C. 2707(c). Embezzlement is covered by other statutes, *e.g.*, 18 U.S.C. 648, 649. It is not clear that the partners would have been guilty of embezzlement. See *United States* v. *Johnston*, 268 U.S. 220.

(R. 73).[37] The unemployment tax is imposed on the employee (I.R.C. 1400) but I.R.C. 1401(a) requires that it be collected by the employer "by deducting the amount of the tax from the wages as and when paid."[38] The income taxes were withheld pursuant to I.R.C. 1622(a)[39] which requires that, "Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to" a stated percentage of the wages.[40] The employer is personally "liable for the payment of the tax required to be deducted and withheld" (I.R.C. 1623). Such liability attaches as soon as the wages are paid (I.R.C. 1401), has the same attributes as a tax on the employer himself, and may be collected from the employer whether or not he has deducted the taxes from the wages of the employee. *United States* v. *New York*, 315 U.S. 510, 515-516; *United States* v. *Fogarty*, 164 F. 2d 26 (C.A. 8); cf. *New York* v. *Feiring*, 313 U.S. 283. See also, Treas. Reg. 106, Sec. 402.304. If the employer fails to withhold the tax, but the employee pays it, the employer remains liable for penalties or additions to the tax resulting from his failure to withhold it. I.R.C. 1622 (d); Treas. Reg. 116, Sec. 405.301; *United States* v. *Fogarty*, *supra*, at 33. The

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[37] With interest and penalties, the assignor's total indebtedness when the contract was terminated was $616,750.95 (R. 74).

[38] These provisions are derived from Sections 801 and 802 of the Social Security Act of 1935, 49 Stat. 620.

[39] This section is derived from the Current Tax Payment Act of 1943, 57 Stat. 126, 128.

[40] Unless inconsistent therewith, all provisions of law applicable to withholding social security taxes are also applicable to the withholding of income taxes. I.R.C. 1627.

amounts withheld are allowed as a credit against the tax imposed upon the employee, whether or not the employer pays such amounts to the Government. I.R.C. 35; *Grasso* v. *Oehmann*, 54 F. 2d 570, 572 (D.C. Mun. App.).[41]

Clearly, then, the tax indebtedness was an indebtedness of the assignor in its personal capacity; it arose "as and when" wages were paid to employees performing the contract; and collection as a tax indebtedness could have been effected from the assignor without regard to whether or not there had been a withholding. Sec. 3661 of the Internal Revenue Code (*infra*, pp. 46-47), impressing a trust upon the moneys withheld, does not effect a discharge of the original indebtedness and does not change the character of the indebtedness; nor does it deprive the Government of its action at law to obtain payment. A person who is required to collect and pay over to the United States another's tax is a debtor of the United States. Such has been the rule both before (*United States* v. *Johnston*, 268 U.S. 220) and after (*United States* v. *First Capital Nat. Bank*, 89 F. 2d 116 (C.A. 8)) the enactment of I.R.C. 3661. The basic fallacy in petitioner's argument (Br. 13) that the assignor was not "indebted" to the United States after the

[41] The employer is not liable to the employee or to any person for the amount deducted and withheld. I.R.C. 1623; cf. I.R.C. 1427, 1608; *Grasso* v. *Oehmann*, *supra*. The withholding of the taxes from the employee's salary effects an immediate change of position so far as the Treasury is concerned. Thus, Treas. Reg. 116, Sec. 405.401 provides, "If the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer."

taxes were withheld, and that the "sole remedy" of the United States is an action in equity to compel a turnover of the trust *res* or for misappropriation of the funds, lies in petitioner's failure to recognize that the provisions of I.R.C. 3661 creating a trust fund provide an additional, rather than an exclusive, remedy to the Government in aid of the collection of taxes. It has long been settled that the Government may enforce a tax indebtedness by the common law action of debt (*United States* v. *Chamberlin*, 219 U.S. 250, 260-263; *Price* v. *United States*, 269 U.S. 492, 500; *Shriver* v. *Woodbine Bank*, 285 U.S. 467, 478-479; *Milwaukee County* v. *White Co.*, 296 U.S. 268, 271), and that a specific remedy for collection provided in the revenue statute is not to be regarded as the exclusive remedy, but merely as cumulative, unless there is something in the statute or its legislative history to indicate that the United States is to be deprived of its other collection remedies. *Ibid*; *Leighton* v. *United States*, 289 U.S. 506; *Phillips* v. *Commissioner*, 283 U.S. 589. Needless to say, such a deprivation of a remedy to enforce collection of taxes should not be lightly found.

Nothing in the language of Section 3661 suggests that it is to be the exclusive remedy or that other remedies are barred. The legislative history clearly indicates the contrary—that it was intended as an additional remedy to the action for debt. The section was added to the Internal Revenue Code as part of the Revenue Bill of 1934, 48 Stat. 768. The Senate Committee, in explaining the new provision,

stated (S. Rep. No. 558, 73rd Cong., 2d Sess., p. 53):[42]

> Existing law provides with respect to a number of taxes that the amount of the tax shall be collected or withheld from the person primarily liable by another person, who is required to return and pay to the Government the amount of the taxes so collected or withheld by him. This is true, for example, in the case of the taxes on admissions, checks, and telephone and telegraph services. Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distraint. Section 606 of the bill as reported impresses the amount of the taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes.

This explanation can hardly be read as indicating that the legislative purpose was to deprive the United States of its remedies for debt and to substitute trust remedies as the sole method. Rather, it is clear that the latter were provided as an additional means of enforcing the collection of taxes. The section is particularly useful in assuring payment or priority where the one who collects the taxes transfers the funds to another, or where the amounts withheld are the subject of

[42] See also H. Rep. No. 1385, 73rd Cong., 2d Sess., p. 32.

an insolvent estate. See, *e.g.*, *United States* v. *Sampsell*, 193 F. 2d 154 (C.A. 9); *Hercules Service Parts Corp.* v. *United States*, (C.A. 6), decided April 2, 1953. If the funds have been kept separately and are identifiable, trust remedies are readily available, but if the funds cannot be traced the United States may assert its claim as a tax indebtedness (as distinguished from a trust indebtedness) and receive priority as such. *United States* v. *New York*, 315 U.S. 510; *In re Frank*, 25 F. Supp. 1005 (S.D. N.Y.); and see second sentence of I.R.C. 3661 (*infra*, p. 47). See also, *Note*, 60 Harv. L. Rev. 786 (1947).

Finally, petitioner's argument (Br. 13) that, with the trust fund intact, the Government's "sole remedy" is an action in equity to compel turning over the trust *res*, and that with the trust fund dissipated, the action is for the amount of the "embezzlement" (by which we assume petitioner means an action for conversion), rather than for a simple indebtedness, is contrary to fundamental principles of the law of trusts. These elementary principles hold that where one person receives money in trust for another and does not live up to the trust, the aggrieved party may sue either for breach of trust *or* for money had and received. Where a trustee is under an immediate and unconditional duty to pay money to the beneficiary, which even petitioner must admit is the situation here, "the beneficiary can maintain an action of debt or general assumpsit or the modern equivalent of these actions under the codes" (2 Scott, *Trusts*, § 198.1). There is no need to resort to equitable

doctrines or to allege that a trust was created and that its *res* was misappropriated. The action against the trustee is simply an action at law for money had and received. *McKee* v. *Lamon*, 159 U.S. 317, 322; *Allen* v. *White*, 17 Wall. 207, 210; *Carl Byoir and Associates, Inc.* v. *Tsune Chi Yu*, 112 F. 2d 885 (C.A. 2), certiorari denied, 311 U.S. 699; Scott, *Trusts*, §§ 198-198.3; *Restatement of Trusts*, § 198.[43] The availability of the action at law for money had and received is highlighted by the fact that here the United States may be regarded, not only as the sole beneficiary of the trust, but also as its settlor. Moreover, the record does not show that any separate fund was set aside or separately deposited which would take on the characteristics of an identifiable trust *res*, without which there may be some question whether the trust provisions of Section 3661 could come into play.[44]

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[43] For similar reasons, there is no substance to petitioner's argument that there is "lack of mutuality" for the set-off because it is based on an "embezzlement" (Pet. Br. 10-11). Even if such a doctrine of mutuality applies to the United States (see *supra*, pp. 19-20), petitioner's contention falls with its argument that the Government's exclusive remedy is for breach of trust. The United States may waive the asserted "embezzlement" and recover upon an implied contract. *Allen* v. *White*, 17 Wall. 207, 210.

[44] Compare, *In re Frank*, 25 F. Supp. 1005, 1006 (S.D. N.Y.) and *In re Independent Automobile Forwarding Corp.*, 118 F. 2d 537, 539 (C.A. 2), reversed on other grounds, *sub nom.*, *United States* v. *New York*, 315 U.S. 510, with *United States* v. *Sampsell*, 193 F. 2d 154 (C.A. 9); *Hercules Service Parts Corp.* v. *United States*, C.A. 6, decided April 2, 1953; and *Shipe* v. *Consumers' Service Co.*, 28 F. 2d 53, 54 (N.D. Ind.).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Claims should be affirmed.

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APRIL, 1953.

APPENDIX

1. *Anti-Assignment Statutes*

a. The Anti-Assignment Statute, R. S. 3477, as amended, 31 U.S.C. 203 (1934 Ed.) provided in pertinent part as follows:

> 203. Assignment of claims void.—All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof.
> * * *

b. The Assignment of Claims Act of 1940, 54 Stat. 1029, 31 U.S.C. 203, provided as follows:

> AN ACT
>
> To assist in the national-defense program by amending sections 3477 and 3737 of the Revised Statutes to permit the assignment of claims under public contracts.
>
> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That sections 3477

and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: *Provided,*

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written

notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department [45] or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

SEC. 2. This Act may be cited as the "Assignment of Claims Act of 1940."

c. The Act of May 15, 1951, 65 Stat. 41, 31 U.S.C., Supp. V, 203, provides as follows:

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[45] Amended so as to include the Department of the Air Force by the Act of July 26, 1947, 61 Stat. 501, 508, 31 U.S.C., Supp. III, 203.

AN ACT

To facilitate the financing of the defense contracts by banks and other financing institutions, to amend the Assignment of Claims Act of 1940, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1 of the Assignment of Claims Act of 1940, approved October 9, 1940 (54 Stat. 1029), is amended by striking out all after clause 3 of the proviso and inserting in lieu thereof the following:

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with (a) the contracting officer or the head of his department or agency; (b) the surety or sureties upon the bond or bonds, if any, in connection with such contract; and (c) the disbursing officer, if any, designated in such contract to make payment.

"Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940, as amended, shall constitute a valid assignment for all purposes.

"In any case in which moneys due or to become due under any contract are or have been assigned pursuant to this section, no liability of any nature of the assignor to the United States or any department or agency thereof, whether arising from or independently of such

contract, shall create or impose any liability on the part of the assignee to make restitution, refund, or repayment to the United States of any amount heretofore since July 1, 1950, or hereafter received under the assignment.

"Any contract of the Department of Defense, the General Services Administration, the Atomic Energy Commission, or any other department or agency of the United States designated by the President, except any such contract under which full payment has been made, may in time of war or national emergency proclaimed by the President (including the national emergency proclaimed December 16, 1950) or by Act or joint resolution of the Congress and until such war or national emergency has been terminated in such manner, provide or be amended without consideration to provide that payments to be made to the assignee of any moneys due or to become due under such contract shall not be subject to reduction or set-off, and if such provision or one to the same general effect has been at any time heretofore or is hereafter included or inserted in any such contract, payments to be made thereafter to an assignee of any moneys due or to become due under such contract, whether during or after such war or emergency, shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States or any department or agency thereof which arises independently of such contract, or hereafter, for any liability of the assignor on account of (1) renegotiation under any renegotiation statute or

under any statutory renegotiation article in the contract, (2) fines, (3) penalties (which term does not include amounts which may be collected or withheld from the assignor in accordance with or for failure to comply with the terms of the contract), or (4) taxes, social security contributions, or the withholding or nonwithholding of taxes or social security contributions, whether arising from or independently of such contract.

"Except as herein otherwise provided, nothing in this Act, as amended, shall be deemed to affect or impair rights or obligations heretofore accrued."

2. *Set-Off Statutes*

a. 62 Stat. 942, 28 U.S.C. 1503, provides as follows:

§ 1503. Set-offs.

The Court of Claims shall have jurisdiction to render judgment upon any set-off or demand by the United States against any plaintiff in such court.

b. R.S. 236, as amended, 42 Stat. 24, 31 U.S.C. 71, provides as follows:

SEC. 236. All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office.

3. *Internal Revenue Code*

The Internal Revenue Code provides in pertinent part as follows (26 U.S.C.):

§ 1400. Rate of tax.

In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages * * *.

§ 1401. Deduction of tax from wages—(a) Requirement.

The tax imposed by section 1400 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.

(b) Indemnification of employer.

Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * * *

§ 1622. Income tax collected at source—(a) Requirement of withholding.

Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to the sum of the following: * * *

§ 1623. Liability for tax.

The employer shall be liable for the payment of the tax required to be deducted and with-

held under this subchapter, and shall not be liable to any person for the amount of any such payment.

* * * * *

§ 3661. Enforcement of liability for taxes collected.

Whenever any person is required to collect or withhold any internal-revenue tax from any other person and to pay such tax over to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

U. S. GOVERNMENT PRINTING OFFICE 1953 250720 1470